MODERN BUSINESS

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Modern Business

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AND FIRST EDITOR-IN-CHIEF
OF THE

MODERN BUSINESS SERIES

Commercial Law

By

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New York

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PREFACE

Modern business is a structure of increasing complexity, and the law is a matter of increasing complexity. The relationships between law and business, moreover, are becoming rather more intimate. Corporate enterprise has introduced into the business field a host of legal questions that were practically unknown to average experience in an earlier generation. Business activities literally are circumscribed by the body of the law—which gives here its sanction to a course of action; at another point imposes limits to a course of action; in some cases establishes exact courses of procedure to be followed; and, in other cases, merely marks out general paths.

It is true that a business career may be followed by one who has no knowledge of the law, but it is equally true that the career is attended with danger, and the steps of the one who follows it are less certain and firm than the tread of one who, in general, knows his rights and understands his responsibilities.

Granting that a knowledge of the law is desirable, and even necessary, for a complete business equipment, the question remains: How complete should that knowledge be? A complete legal training assuredly is not required; rather, the necessity is for

a clear, simple statement of principles, in language understandable to one who has had no previous acquaintance with the law. It is this approach to the subject that the Text on "Commercial Law" supplies. Fundamental facts of law are presented definitely, concisely, and in non-technical terms. The material has been carefully condensed to eliminate needless ramifications, but all the law affecting business is included in sufficient detail to furnish a clear, comprehensive grasp of the subject.

The author of the Text brings to his task a happy combination of training and experience. Frank H. Sommer, J. D., Dean of the New York University School of Law, has been engaged in teaching law, as a member of the faculty of that institution, since 1895. His experience, from this connection, is that of a teacher, accustomed to state and to interpret the law, so that it may be understood and remembered readily. In addition to his teaching experience, Dean Sommer brings also a long experience as a leading practioner in the courts of his state. There is brought to bear, therefore, in his presentation a knowledge of the law in its practical aspects—its everyday contacts with business—which lifts the exposition above the purely theoretical and didactic, and brings out the important factors in the manner most serviceable to the man requiring the knowledge as a guide in his business affairs.

EDITOR-IN-CHIEF.

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COMMERCIAL LAW

CHAPTER I

LAWS GOVERNING BUSINESS

1. *The "rain" of law.*—Laws governing the conduct of business and other phases of everyday life are becoming legion. Decisions of courts of last resort, to say nothing of courts of inferior jurisdiction, are accumulating in formidable bulk. From Congress and from State legislatures an unending stream of legislation is adding to the complexities of the law. The regulatory powers of administrative bodies, such as the Interstate Commerce Commission, The Federal Trade Commission, State Public Service Commissions and similar bodies and orders issued pursuant to these powers, circumscribe the limits within which business may move freely. Ordinances and regulations prescribed by local governing bodies and departments, such as building codes, fire prevention ordinances, and traffic regulations, further restrict freedom of action. The ever-increasing downpour of precedent, legislation, regulation, and ordinance has been aptly termed "The Rain of Law."

The problems presented by this growth in our body

of law are of concern both to the lawyer and to the layman. The lawyer must keep abreast of the current. The business man should keep in general touch, at least, with the trend and development of the law. The law affects business from almost every side. It has phases which are so intimately involved in the conduct of business that they need to be understood as clearly by the business man as by the lawyer.

In this Text it is purposed to select from the great body of law those principles that apply to the transactions most frequently occurring in everyday business affairs, and of which the business man should have a clear, though general, understanding. In no sense is it purposed to qualify a business man to be his own lawyer.

2. *The law's debt to business.*—The law is not a collection of rules and precepts which courts and legislative bodies have laid down arbitrarily. The law, as we know it, has its origin in the customs of the people. The decisions of courts have crystallized these customs into definite rules, and legislative bodies have, from time to time, redeclared the existing law, effected changes in it, and broadened the field of its operations as the habits and the customs of the people and changed social and economic conditions demanded at the time.

In the early days of the history of the common law, it was a body of jurisprudence admirably adapted to an agricultural and feudal society, but one which would be deficient for a commercial or industrial

society. With the growth of industry and commerce, the law was required to extend into new fields and to adapt itself to changing conditions. Over the past century, manifold changes have come about in the law itself, and its purview has widened. In its development, it has kept pace fairly with the evolution of an industrial and commercial society. It stands today fairly well adapted to the conditions of our commercial and industrial world.

3. *The Law Merchant.*—An illustration of the foundation of the law upon business customs is found in the practices comprising the Law Merchant. Some of the principles governing the commercial transactions of today, such as sales of goods, and commercial paper, find their origin in the customs of merchants in medieval England, out of which the law merchant grew. Administered first by extra-legal tribunals, the binding force of these customs was recognized and caught up in the current of judicial decision, making the customs of the law merchant so integral a part of the common law of England that they have always been part of the common law of the individual states of the Union, which took over the English common law as it was administered in the Colonies before their independence.

4. *Meaning of the common law.*—The term "common law" is used in one sense to distinguish the system of jurisprudence found in England, in English Dominions and Colonies which follow the English system, and in the United States, from the system

of jurisprudence, radically different in some of its phases, current in Continental Europe.

The jurisprudence of most of the states is based upon the common law. The jurisprudence of Louisiana has a Continental European origin. Florida, Arizona, and New Mexico, with Continental European law heritages arising from Spanish settlement and occupation, have adopted the common law by legislative enactment.

The term "common law" is used also to designate the body of law arising from judicial decisions as contrasted with the law which proceeds from legislative enactment.

Sometimes, rather confusingly, the common law is referred to as the "unwritten law." It is unwritten in the sense of not being embodied in legislative enactments, but the decisions of courts are written and handed down for future guidance, just as statutes are written. It has been noted above that the common law has developed, and is developing, in accordance with changes in the conditions under which the people live. The changes in the current of judicial decisions are not always abreast of changes in the opinion and habits of the people, but this is due not so much to rigidity as to a differentiation of function between the courts and legislative bodies, to which reference will be made below. We are dwelling upon the common law first, because even the statute law finds its root in the soil of the common law. All statutes which are declaratory of the existing law,

and many statutes which superimpose changes upon the existing law, have an ancestry directly traceable to the common law.

5. *How the common law is declared.*—Originally, the decisions of courts gave force to prevailing custom. Today, there is little occasion to give force to prevailing custom, but the need continues for declaring and interpreting the law with reference to varying states of fact.

The decisions of courts which declare the common law are those of the courts of appellate jurisdiction, courts of last resort, or courts not of last resort but of general jurisdiction, with power to hear appeals from lower courts. These decisions are compiled in official reports in various states and issued in bound volumes. Private agencies also are engaged in gathering, indexing, printing, and distributing the decisions of courts in all jurisdictions. Decisions by courts of last resort, or of superior jurisdiction, are binding upon inferior courts in the same jurisdiction. Thus, an element of stability is introduced, and the law is welded together so that its application is certain and uniform throughout the area over which a superior court's jurisdiction extends.

6. *Certainty and flexibility.*—Because the law, as applied in an individual case sometimes seems repugnant to what appears to be the essential justice of the matter, fault is found with the courts for their rigid adherence to precedent. It is desirable that the law be flexible and that it keep pace with the progress of

society. It is also not only desirable, but necessary, that the law be definite so as to be predictable. It is better to know with certainty what the law is, even though it may be somewhat antiquated and out of joint with the times, than to live in a state of society where the law is constantly changing and therefore not predictable. Business men would be deterred from that long-term planning which is essential under modern business conditions; uncertainty and doubt would rule, if the law were not stable.

It is in consequence of this situation that courts adhere to precedent, particularly in administering the law affecting contracts and property, leaving the inauguration of changes to the legislature. With branches of the law in which certainty and predictability are less essential, there is a growing tendency for the courts to alter, modify, and remold established rules to meet the requirements of new conditions.

There are weighty reasons for the differentiation of functions between courts and the legislature in contributing to the growth of the law. When changes in existing rules are made by the courts, the decision is handed down as applicable to the state of facts before the court, and the law, as declared, stands as if it had been so from the beginning. The legislature, in enacting a statute, may make it speak entirely as of the future. The courts, on the other hand, cannot preclude their declarations of the law from having retroactive effect. Thus, the law, under the influence

both of judicial decisions and statutes, is constantly in process of being molded to conform with changes in business practice, changes in modes of living, and changes in ethical standards.

7. *Law is a body of principles.*—From what has been said, it appears that the law is not a homogeneous institution in all jurisdictions. Variations in its interpretation, legislative changes in its structure and application, and other differences are found as we progress from state to state—from jurisdiction to jurisdiction. It is not possible, nor desirable, in a Text such as this, to consider the law in detail as applied in the different jurisdictions. It is possible, however, to study the principles that have been accepted generally and that, with some variations, underlie the rules as administered and applied in most of the states of the Union. In this study of the branches of law that particularly affect business, then, we are engaged, not in studying the details and refinements of law as administered in any particular jurisdiction, but in studying the underlying general principles out of which the interpretation and administration of the law proceeds.

8. *Statutes and codes.*—Statutes may be passed by legislative bodies for the purpose of gathering together and redeclaring existing law. They may be passed also for the express purpose of making changes in the existing law and extending the law to cover newly developed fields of activity. When a legislative body enacts a statute that declares, in some

respect, a rule of law differing from the common law rule prevalent in the jurisdiction, the statute supersedes the common law and becomes the law of that jurisdiction.

The varying effectiveness of statutes illustrates, again, the close connection between law and the business and social habits of the people. A statute that merely redeclares existing law, or conforms to general custom or belief, is absorbed into the body of law readily. Statutes that enact laws which do not have a firm root in popular custom or belief, lose in efficacy through the difficulty of inducing changes in the accustomed practices of the people, while statutes that declare rules or principles of law which are no longer in keeping with the thought and practice of the times gradually become obsolete.

9. *Uniform laws.*—Although the states are separate and distinct jurisdictions, a vast amount of commerce is interstate in its nature. As the volume of business has grown, the desirability of greater uniformity in the laws of the various states, particularly with regard to everyday commercial transactions, has become more apparent. In furtherance of the desire to relieve business enterprise of the complications arising from different and conflicting rules of law applicable in different jurisdictions, various acts, substantially identical, have been passed in a large number of states. These are known as uniform acts. They are not dictated by external bodies, but they are drafted, after careful consideration of existing

laws, by commissions appointed for the purpose, and then introduced into, and enacted by, different legislatures, as sentiment groups to support the desirability of making the laws of the given state conform with those of other jurisdictions. In this way, uniform acts have been passed by the legislatures of a large number of states declaring and codifying the law affecting such important commercial fields as sales, negotiable instruments, bills of lading, partnership, limited partnership, and stock transfers.

In studying the principles of law that govern the relations and the transactions covered by these uniform acts, it is possible to proceed with greater definiteness and certainty than in the study of the principles of common law as evidenced by the decisions of the courts. There are varying interpretations of the uniform acts in different jurisdictions, but the variations are not so great, on the whole, as those to be found in the application of common law principles by the courts of the several states.

10. *Interpretation and construction.*—Although a statute passed by the legislature repeals the common law, if the latter is in direct conflict with the law declared by the statute, the passage of a law by a state legislature, or by Congress, is often not the last word in the way of declaring the law.

In the first place, the laws passed by legislative bodies must be constitutional—that is, they must not contravene the commands or the prohibitions of the state or federal constitution. It is the province of

the courts to determine the constitutionality of statutes. When a court of ultimate jurisdiction declares a statute to be unconstitutional in whole or in part, that decision abrogates the statute to whatever extent the unconstitutionality extends. In this power to declare statutes unconstitutional, the courts do not sit as superior reviewing bodies over Congress and legislatures. They sit, rather, as the bodies which enforce the supreme law of state or nation, viz., the constitutions which have been adopted by the people as their fundamental charters.

Further, it is the function of the courts to interpret statutes. The language of a statute may be ambiguous, and here the decision of the court of last resort, interpreting the statute in accordance with the presumed intent of the legislature, adds the court's ruling to the law as declared by the statute. The courts, likewise, are called upon to reconcile conflicts between different statutes, when they appear, and to harmonize the law declared by a statute with the existing body of the common law. While it is true that statutory law supersedes the common law if there is a direct conflict, there are also numerous cases in which there is a question as to how far the legislature intended to go in substituting a rule declared by statute for the rule previously obtaining.

From the foregoing, it may be seen that, just as the common law is to be found in judicial decision, so the law declared by statute is to be found, in part, in the statute, and, in part, in the judicial decisions

which have interpreted the act. Thus, it is unsafe to rely upon what appears to be a clear wording of a given statute. While the section of the statute, standing alone, may be clear and unambiguous, the court reads it in the light of the past, and again may be compelled to reconcile it with existing law. In so doing, a meaning may be declared other than that which the wording of the statute, considered alone, appears to convey.

11. *Equity.*—At a comparatively early stage in the development of the common law of England, the administration of law in accordance with precedent not infrequently made for injustice, or for a failure of justice in individual cases. When suitors found that the remedies of the common law were inadequate, or that the common law offered no remedy, or that injustice would be wrought in a given case, appeal was made to the king as the fountain of justice. The king, by his decree, might remedy the situation in which his petitioning subject was found. In the course of time, the appeals to the king came to be handled by the Lord Chancellor as the "Keeper of the King's Conscience." Cases so coming before the chancellor were decided in accordance with his sense of justice. The chancellor, in those days, was an ecclesiastic, and he brought to his office a knowledge of the civil law and the canon law—knowledge which influenced his conception of justice.

The law thus administered was known as equity, as distinguished from the common law. Because of

the greater flexibility of equitable remedies, the chancellor's court was enabled to do justice in many cases where the common law, either by reason of the necessity of observing precedent, or by reason of the limited nature of remedies available, was insufficient. In the early days of development of equity jurisprudence, it may have been true that "Equity is a roguish thing, varying with the length of the Chancellor's foot," but, as equity developed, precedents for its administration were established. The body of equity law is no longer intangible, but a collection of precedents applying to the subjects over which equity exercises jurisdiction.

The equity jurisprudence of today does not rest upon the court's mere sense of justice; nor, to the layman, is equity a thing greatly distinguished from common law. Equity and law are now administered in most jurisdictions by the same judge sitting in the same courts. Nevertheless, the rules of equity which have been evolved provide a present relief from some of the rigors of the common law. In a suit at law, for instance, only money damages or the restoration of real or personal property can be awarded. But there are cases in which these remedies are inadequate to work justice. The law action, too, is a formal matter between two parties, or sets of parties. Third parties may be involved, but no means existed at law to bring them into the proceeding and so determine all rights and liabilities in one action. A man must have his day in court and, because in such case

the third party was not a party to the proceeding, he was not bound by the judgment rendered therein. Courts of law, also, lack the means of controlling the future actions of the parties, and they lack the ability to forbid anticipated injuries and to insure compliance with a decree by means of a positive command addressed to a defeated party.

12. *Equitable remedies.*—By the administration of rules of equity, the courts are enabled to overcome these deficiencies of the law. To take a concrete example, two persons may have entered into a contract for the sale of a parcel of land. The owner of the land may fail to live up to his contract. The buyer has the right to sue at law for such damages as he may be able to prove. But damages may be a poor recompense. The circumstances of the case may make the parcel of land worth more to him than the damages he could prove and recover in an action at law. Consequently, a court of equity would direct specific performance of the contract by the owner. That is, it would not award damages, but would command the owner to convey the land to the buyer.

By the writ of injunction, an equitable remedy, the court may prohibit the commission of acts tending to injure the complainant, if the injury is one not adequately redressed by money damages. An instance of the value of injunction as a remedy may be found in cases of unfair competition. A business man whose business is being impaired by infringement of patents, or trade-marks, by misbranding or "passing

off," may sue the infringer for damages. But every day the unfair competition continues he may actually be losing business to his competitor. It is vital that he be able, not merely to recover damages, but also to put a stop to the unfair practices from which his business is suffering. The action at law would result, at best, in an award of money damages—surely an inadequate remedy. It would give relief only after much of the damage had been done, and, if for any reason the defendant should be unable to pay the damages awarded, relief would be wholly illusory. Injunction puts a stop to the continuation of the damaging practices.

Through the application of equitable principles, the courts are able, also, to continue a going business through a receiver, acting as an agent of the court, until its difficulties can be overcome, thereby avoiding the great losses that would occur if a business had to be wound up and sold at scrap value when it ran into the shoal waters of finance.

In the settlement of the affairs of partnerships, courts of equity have power to decree an accounting, thereby bringing numerous points at issue to a head in one action. They exercise control, also, over the administration of trust funds and trust estates. Beneficiaries are thereby enabled to petition the courts for an accounting or for the removal of a trustee whose actions are claimed to be in violation of his trust. The trustee, himself, when in doubt as to his duties, or when in doubt as to the proper construction

of the instrument creating the trust, may apply to the court for its direction as to his administration of the trust, and for its construction of the instrument.

Equity jurisprudence, as it is today, rests upon precedents in much the same manner as does the common law. Equity is no longer variable with the conscience of the chancellor. It is now certain and therefore predictable; its rules are defined and its remedies well marked out. It is a system of law complementing and supplementing the system of the common law. It gives flexibility to the administration of law.

13. *The courts.*—Each state is a separate jurisdiction. The systems of courts vary, but, in general, there will be found courts primarily for the trial of cases in which the great bulk of actions are fought out, and a court of last resort which does not sit for the original trial of cases, but which sits as a court of appeal and review. Intermediate courts not infrequently possess both original and appellate jurisdiction.

There is no common law of the United States. The federal courts sit to administer cases falling under their jurisdiction under treaties, the United States Constitution, and statutes passed from time to time by Congress, in accordance with the Constitution. The principal classes of commercial cases which come into the federal courts are those arising under federal acts relating to interstate commerce; suits between citizens of different states where the amount at issue is sufficiently large to bring it within the jurisdic-

tion of the federal courts; and bankruptcies, patents, and matters dealt with by Admiralty Law.

14. *Substantive and adjective law.*—The principles of law, which have to do with the rights and the duties of persons, with the obligation of contracts, and with the law affecting property, are given the general designation Substantive Law, as distinguished from the law governing procedure for the enforcement of rights and the recovery of penalties, which is known as Adjective Law. A long time before any question as to the adjective law arises, the business man will have need for the services of a lawyer. The scope of this Text, accordingly, is confined to principles of the substantive law. Moreover, it is not intended or desired that the treatment shall be exhaustive.

15. *Where the law touches business.*—The interrelationship between business and the law is close, and the points at which the law touches business are manifold. There are points at which business comes in touch with the criminal law—that body of law which defines certain acts as offenses against the state and provides for their punishment. In the field of criminal law, the action is not between individual and individual, but the proceeding is a prosecution—the state arraigned on one side, through its law officers, against the defendant on the other side. Business men and business houses do not wittingly carry on their operations so as to run foul of the criminal law. Because of the fact that the criminal law

touches business but incidentally, its treatment finds no place in these pages.

There is a class of wrongs known as "torts." The acts involved in these wrongs are illustrated by slander and libel, by fraud, by negligence, by trespass to person and to property, and by malicious prosecution. When business relations are affected by this field of law, it is incidental and not a matter inherent in the conduct of the business. The field embraced by the law of torts is therefore not dealt with herein, except as unfair competition and malicious interference with contractual relations is considered.

There remains to be considered, nevertheless, a body of law of impressive size, which is likely to affect the everyday transactions of every business house and every business man. There are the laws affecting the formation, the performance, and the discharge of contracts; laws affecting instruments given as payment, or means of payment; the relationship between partners, between principal and agent, and between employer and employee; corporations and the laws affecting title to property and its transfer, all so closely allied to business transactions that they are aptly included under the general designation of Commercial Law, as distinguished from branches of law which touch business more remotely.

These are the subjects covered by this Text. The treatment is designed to explain clearly the principles of the law so that those who tread the paths of business may be aware of the pitfalls; so that knowledge

of the law may be reasonably definite, and not merely an impression that certain things are true and that certain things are not true. The study of commercial law by a business man should have two purposes, both of which it is the effort here to further—a knowledge of the law sufficient:

(a) To enable him to recognize the point at which individual reliance upon a general knowledge of the law should be laid aside and replaced by the skilled services of a professional man
(b) To enable him so to conduct his affairs as to reduce the need of litigation to the minimum

REVIEW

What divisions of law are an outgrowth of the customs of the merchants of medieval times?

State what is meant by the term "common law."

Explain how the rules of the common law are established.

What rule prevails when a statute which conflicts with the common law is passed by a legislative body?

To know the prevailing law on a given point, what must be considered besides the language of a statute which apparently covers the matter?

Outline the origin of equity jurisprudence.

Name three equitable remedies.

NOTE: The reviews throughout this Volume are for the personal convenience of the reader in testing his understanding of the chapter. It is not necessary or desirable for subscribers to submit written answers to the Institute except in a case where they may feel uncertain as to their grasp of the question under consideration.

CHAPTER II

CONTRACTS—REQUISITES

1. *Definition.*—Contracts are promises enforceable in courts of law. We must ascertain, therefore, the conditions under which promises have the sanction of the law. The very term "contract" raises the thought of agreement. Though agreement is the essence of contract, not every agreement results in contract. A distinction must be drawn between an agreement made by two people for a meeting to discuss business plans, and an agreement which they may reach at that meeting to carry out some business plan. Two persons may agree to come together at a later time for the purpose of discussing a contemplated sale of a parcel of real estate. If either of them failed to appear at the place of meeting, it would not occur to the other that he had any legal recourse, nor would he consider himself damaged. But, if the meeting took place, the parties agreed to the terms of the sale, and signed a contract for the sale of the property, either party would consider himself damaged by a later default of the other, and proceed to seek legal remedy.

The distinction between these two situations lies primarily in the fact that, in the first, the parties

cannot reasonably have contemplated legal consequences to flow from their agreement, and that, in the second, their agreement had for its object the effecting of a legal relationship and contemplated legal consequences.

Out of the first situation no legal obligations emerge. In the second, legal obligations are incurred and rights arise to fulfillment of the promises made.

2. *Essentials of a contract.*—The fundamental requisite of a contract, then, is agreement, or the mutual assent of the parties to the promise, or promises, that constitute the contract. Agreement, or mutual assent, arises from an offer made by one party which is accepted by the other. The offer may be either expressed in words or implied from the facts, and the acceptance may likewise be either expressed or implied; but offer and acceptance, in some form, are essential. There are other requisites, which will now be noted.

Every contract must be based upon consideration. Consideration, in general, may be defined as some act performed, something given, or something promised to be done or given, in exchange for a promise. Consideration may be money payment, it may consist of acts or services, it may be found in a party's refraining from some action, or it may be a counter promise. The underlying principle of the requirement of consideration is that the courts will not enforce gratuitous promises.

To this principle, promises in writing executed by

the promisor, with the formality of attaching a seal to the promise, presented an exception at common law. Such formal promises were enforced, though gratuitous. It was said that the seal raised a presumption of consideration, which presumption the law would not permit to be rebutted and overcome by showing that the promise was, in fact, gratuitous. This position of the promise under seal has been modified by statute in most jurisdictions, as will be noted hereafter.

Further, it is requisite that the parties be capable, in the eyes of the law, of assuming a contractual relation. The identity of a married woman was, under the common law, so merged in that of her husband, that she wholly lacked power to contract. From this total disability to contract, the married woman has been relieved by modern statutes.

An insane person who has been formally adjudged a lunatic, and for whom a guardian has been appointed, is wholly wanting in capacity to contract. These instances illustrate what is meant by a disability to contract.

Care should be taken, however, to note the difference between these cases in which capacity to contract is wholly lacking, and cases such as that illustrated by the contracts of infants, where a contract arises, subject to avoidance on the ground of infancy. The right of disaffirmance is available to the infant alone, and no right to disaffirm is possessed by the other party to the contract. These requisites of contracts

will be taken up in detail in subsequent chapters.

3. *Kinds of contracts.*—We have noted that the offer and the acceptance, or both of them, may be either expressed or implied. This condition gives rise to a classification of contracts into:

(a) Express, where the promise is expressed, either orally or in writing
(b) Implied, where there is no express promise but, where, from the nature of the transaction, the facts imply a promise

It is to be noted that these contracts are alike in every respect except the manner in which the agreement is evidenced. In express contracts, the parties have set forth their intent in words. In implied contracts, no promise in words is present, but the nature of the transaction infers agreement and promise. Of a different *genus* are quasi contracts, which are not true contracts but which proceed from circumstances in which the law permits one party to bring an action founded on the legal fiction of a contract. This legal fiction is considered later.

4. *Express contracts.*—Contracts of this kind, where the terms are set forth in words, may be either formal or simple contracts. A formal contract is one embodied in writing and under seal. All other contracts are simple contracts. It follows, from this fact, that a simple contract may be either in writing, or it may be merely an oral agreement between the parties.

Except in cases where a statute requires a contract

to be in writing, there is no distinction between the legal force of a simple contract in writing and a simple contract made by word of mouth. Obviously, however, while the law does not, in general, draw a distinction between the written and oral forms, so far as force of the contract is concerned, proof of the written contract is a much easier matter, and reduction of the contract to writing is always a desirable step, since it places the undertaking in black and white, and obviates controversy as to its terms.

In this connection, it should be noted that care is desirable in order to make sure that the written contract is clear and free from ambiguity, and that it leaves out no essential terms. This precaution not only is desirable for the sake of its business value—clarifying the matter in the minds of the parties—but also its desirability will be better appreciated if the contract becomes the subject of litigation. There is a rule of law which holds, in substance, that a written instrument, apparently complete in itself, may not be altered or varied in its terms by a contemporaneous oral understanding. The written instrument may be explained, or it may be amended by agreement. But those things to which parties may agree at the time of forming the contract, but which they fail to include in the written instrument, will not be permitted to be proved.

Contracts should not only be in writing, but also they should be read carefully by the business man, as well as by his lawyer, to make certain that all

essentials of the agreement are included, that no unessentials are included, and that there is no question between the parties as to the meaning of its terms.

5. *Implied contracts.*—As indicated, implied contracts are those in which the agreement or terms are understood and inferred from the circumstances of the case. An instance of a contract of this type would arise on the performance of requested services where no express promise of payment has been made, and the exact amount and mode of payment have not been made the subject of definite agreement. When a dentist or a doctor is consulted, there is, in the majority of cases, no express promise to pay him; much less an express promise to pay him any particular sum of money. There is, however, an implied contract to pay him the reasonable value of his services. It would be unreasonable to assume that uncompensated service was contemplated, and his right to obtain payment arises from the plain implication of the facts.

6. *Quasi contracts.*—A quasi contract is not a real contract. It is a legal fiction which is raised to afford a remedy to a party in circumstances where it is obviously just that one have a right of action against another. We may suppose the case of a sale of silver tableware. Through a clerical error the bill exceeds the actual price of the articles purchased by $50 and the customer pays the bill, not noticing the error. Later he discovers it. His right to recover the $50 overpayment rests upon the theory that the seller

has money of the purchaser which, in all justice, he ought to repay.

Here the just debt of the seller is recognized by permitting the purchaser to sue for the recovery of his overpayment as though a contract existed for its repayment. In truth, there is no contract, for there is no promise to repay, either express, or by implication of fact. The law here indulges in the fiction of a promise so that one party to the transaction shall not be unjustly enriched at the other's expense.

7. *Executed and executory contracts.*—Another classification of contracts may be made as between those that have been fully performed and those that are yet not fully performed. The contract that has been fully performed by both parties is an executed contract. A contract that, as yet, has not been fully performed by either party is an executory contract. Between these extremes we may have contracts which are executed so far as one party is concerned, and executory so far as the other party is concerned.

8. *Unilateral and bilateral contracts.*—The distinction between contracts embraced in these classifications has to do with whether future performance is to be looked for from one party, or from both parties. The agreement may consist of mutual promises, whereby each promisor agrees to perform some future act. In such a case, the contract is bilateral. Or the agreement may consist not of a promise for a promise, but of a promise for an act, in which case the contract is unilateral. A builder contracts with

a property owner for the construction of his home. The builder's undertaking is for the furnishing of materials and the performance of services in the construction of the house; the owner's undertaking is to pay for the builder's work in accordance with the terms of the contract. Here both parties are obligated to a future performance and the contract is bilateral.

Now, the owner of the property may obtain the money for his payments by borrowing from a bank. When he borrows, he receives a credit from the bank and he executes his promissory notes. The bank has performed its part of the contract, when it extends the credit to the borrower. There remains, however, his obligation to pay the notes. This is a unilateral contract, since the future performance is to be that of one party.

9. *Void, voidable, and unenforceable contracts.*— This classification is sometimes adopted, although, in strictness, it is somewhat anomalous to speak of a void contract. An agreement that is void is one out of which neither rights nor obligations arise. It is, consequently, no contract at all. A contract to carry on some enterprise expressly prohibited by the criminal law is an example of a void contract.

A voidable contract is one that is not essentially invalid but which may be avoided by one of the parties. A contract for other than necessaries, entered into by a person under 21 years of age, is an example of a voidable contract. The infant may

elect to abide by the contract, or he may exercise his privilege of infancy by disaffirming it, in which case the contract is voided.

A contract may be neither void nor voidable, but its enforcement may be prevented by some legal barrier. We may take for illustration the case of a debt on a simple contract, which has been owed for a period of eight or nine years without any payment on account, or without any fresh promise on the part of the debtor. The creditor brings suit on the contract. Statutes of Limitations for actions on simple contracts usually prescribe a six-year period of limitation.

When the creditor brings his suit into court, the law does not say that he has a voidable contract on his hands; the contract may have been perfectly valid. What the law does say is that, since the statute requires an action on a simple contract to be brought within a period of six years from the time the right of action accrued, the court will not listen to proof at this late time, and the contract, accordingly, is unenforceable at law. If the debtor, notwithstanding the statutory bar to a suit, should later recognize the contract by making a payment on account, or should make a definite promise to pay the debt, which promise, in some jurisdictions, is required to be in writing, the defense which the statute affords would be waived and the bar removed.

In the same way, a contract that unduly restrains trade may be unenforceable. An example is afforded

in the case of a physician who sells his practice and agrees not to practice in that community for a period of, say, twenty years. This agreement, assuming it possesses all other requisites, is valid. The restraint is essential to insure that the purchaser obtains what he pays for, i.e., the practice. But suppose that the contract is that the physician will not practice his profession anywhere for twenty years. This agreement would be found unenforceable, if the doctor selling his practice should resume practice. Here there is restraint to which the law will not give effect and which it will not enforce, because it is unreasonable, in that it is broader than is required to protect the purchaser in the enjoyment of that which he has purchased.

10. *Parties to contracts.*—Contracts may be entered into freely by parties who are not under some legal disability. Disabilities may arise, because of the sovereign nature of one contracting party, because of a disability set up by law, or because of lack of authority on the part of those who would enter into a contract in a representative capacity.

11. *Governments as parties.*—The United States Government and the governments of the separate states are sovereign bodies. They may contract through their duly elected or appointed agents, and contracts so made are enforceable by the sovereign body. There is only limited enforceability, however, on the part of the other contracting party. This arises from the fact that a sovereign cannot be sued

in its own courts without its consent. This rule does not apply to counties, municipalities, or other subdivisions of the state. Cities, boroughs, and incorporated villages are public corporations, and counties are quasi corporations, none of them having sovereign powers.

12. *Aliens.*—As a rule, aliens may enter into contracts and enforce them. It follows that they are responsible for full performance. This applies only to aliens whose countries are at peace with the United States.

13. *Infants.*—An infant, in the eyes of the law, is a person under the age of 21 years. Infants are under a disability to enter into contracts except when the contract is for necessities. The theory is that an infant does not possess the discretion requisite for the judicious handling of his affairs. But he has to be permitted to contract for food, necessary for his sustenance, and for wearing apparel and other necessities of life useful to his state in society, and within his resources. Hence arises the exception of contracts for necessities from the general disability of the infant to contract. Even in such cases, liability is limited to the reasonable value of the necessaries.

The contracts into which an infant may enter, it is to be noted, are voidable and not void. This means that the contract may be avoided by the infant, or by a guardian acting on his behalf. But it may also be ratified by the infant after he attains his majority. The disability of infancy is one that is personal to

the party under age, and he alone may take advantage of it. A person who contracts with an infant cannot escape his obligation by pleading that the other party was a minor, if, on behalf of the infant, there is insistence upon the performance of the contract.

Ratification of a contract by an infant, when he becomes of age, may be express, or the ratification may be implied from his conduct in the same way that contracts arise from the acts of parties. Unless there is a statutory requirement to the contrary, ratification is not required to be in any particular form. The mere lapse of time does not raise any necessary implication of ratification, although it may be a circumstance tending to prove ratification by implication.

14. *Effect of ratification.*—When a contract has been disaffirmed by an infant, or by one acting on his behalf, it is thereby avoided, and the other party cannot hold the infant to his obligation. When the infant's contract is ratified, it assumes full force and effect and stands in all respects as if it had been made originally by persons not under disability. The ratification must extend to the whole of the contract. While the infant's contract may be wholly avoided because of his infancy, his interests cannot be furthered by electing to observe some parts of the contract that are to his advantage and repudiating other parts that he does not wish to perform. The ratification must be of the entire contract, or it is no ratification at all.

15. *Return of consideration.*—When an infant's contract is disaffirmed, question arises as to the disposition of the consideration given. There are two viewpoints from which this matter should be regarded. The privilege of interposing infancy as a defense against the contract is to prevent improvident agreements, but it is not designed to enable the infant to enrich himself unjustly.

The general rule is that the infant is under no obligation to return the consideration when he repudiates a contract. Thus, if he has spent money received, or if he has lost or destroyed a piece of property received, he is under no obligation to make good the amount, or return the property, or compensate for the damage as a prerequisite to avoiding the contract. But, if the consideration, or any part of it, remains in his hands when he repudiates a contract, and this fact can be proved, the other party may demand its return.

The purpose of the rule is to keep the infant from being trammeled in his right to disaffirm, through necessity of performing something which may be outside his power, and, at the same time, to prevent injustice by giving the other party a right to recover such part of the consideration as remains with the infant.

It should be noted that the law will not permit the protection so afforded the infant to be evaded by differences in forms of action. For instance, a minor may represent himself to be of full age and so induce

a person to contract with him. In most jurisdictions, the infant is not liable on the contract, and the other party will not be permitted to hold him liable for the misrepresentation, which is a tort. To permit the infant to be sued for the misrepresentation would be to nullify in whole, or in part, his privilege of defense to an action based on the contract.

16. *Insane persons.*—Persons who are of unsound mentality may be:

(a) Those who have been adjudged incompetent by some court
(b) Persons who are of unsound mind and who are known to be so by the other contracting party
(c) Persons who are of unsound mind but who, to all appearances, seem sane and are not known to the other party to be incompetent

When there has been a formal adjudication of lunacy, and a guardian for the lunatic has been appointed, no contracts made by the insane person are valid. The guardian acts for the lunatic, and only the guardian can contract, or disaffirm, or confirm, voidable agreements previously made.

If there has been no formal adjudication of lunacy, a contract made by an insane person is binding on the other party just as an infant's contracts are binding upon the other party. The right to avoid on behalf of the lunatic depends somewhat upon the state to which performance of the contract has proceeded. If a contract has been partly performed by the other party, it may be avoided on behalf of the lunatic, pro-

vided the consideration received by the lunatic is returned.

The weight of opinion also holds that an executory contract may likewise be disaffirmed on the lunatic's behalf, although there is some opinion to the effect that, if the other party did not know of the lunatic's incapacity, the contract cannot be rescinded. If the contract is to the manifest advantage of the lunatic—that is, is fair to him—and the other party had no knowledge of the lunacy, and has entered upon performance so that he cannot be restored to his previous condition, this rule would generally apply.

17. *By whom disaffirmance is made.*—It has been noted, that the privilege of disaffirming a contract on the ground of infancy, or insanity, is one which may be availed of only on behalf of the incompetent party. An infant may disaffirm his contract, or it may be disaffirmed on his behalf by a guardian, and likewise a guardian, or committee, may disaffirm the contract of a lunatic, if the proper grounds exist. In case of the death of an incompetent party, before express or implied ratification, the right survives through his personal representative.

18. *Corporations as parties.*—A corporation is empowered to enter into contracts that are not in contravention of (a) a positive statute, or (b) its own charter. A corporation's charter gives it certain express powers for the carrying on of its business, and other powers are implied as necessary in the conduct of its affairs. Contracts that are entirely

outside the scope of the corporation's activities and in excess of the powers granted by its charter are *ultra vires,* that is, beyond legal authority.

The effect of a contract that is beyond the powers of a corporation is one that it is difficult to summarize, because of conflict in the rules of different jurisdictions. There are some principles, however, upon which there is fair agreement, and these may be set forth as follows.

Despite the fact that a contract is *ultra vires,* if it has been fully performed on both sides, its position as a contract will usually be permitted to stand. The reverse of this condition is found in contracts that are *ultra vires* on the part of the corporation and that, as yet, have not been performed by either party. In this class of cases, neither the corporation nor the other contracting party can hold the other to performance.

In a large number of jurisdictions, it is held that cases in which a plea of *ultra vires,* raised either by the corporation or by the other party, would produce inequitable results are to be distinguished from those where no damage would flow from such a plea. An illustration of such a transaction would be a sale, partly executed, of property either to a corporation, or by a corporation. In the case of a sale by the corporation, if the property is in the hands of the vendee, it is held in these jurisdictions that he cannot set up the plea of *ultra vires* as a defense to an action for the purchase price. Similarly, if the situation is

reversed, the same rule holds true for the corporation as defendant.

In general, when a contract for the sale of property, whether real or personal, is so far executed that title has passed, the contract will not be treated as other than voidable, with a return of the property following upon an election to avoid the contract. In some jurisdictions, a person who contracts with a corporation, and who does not know that the contract is outside the express or implied powers of the corporation, may bring an action upon his contract and recover.

With regard to promissory notes, bills of exchange, and other negotiable instruments issued by the corporation, the general rule is that, unless it is known by the holder that the circumstances giving rise to the issue of the instrument were beyond the express, or implied, powers of the corporation, the instrument will be valid.

19. *Acts of corporate agents.*—This particular phase of the corporation as a party to contracts is treated more properly under the general discussion of agency. It may be remarked here that a corporation acts solely through its agents; that, in some cases, their powers are implied by the nature of their office, and that, in other cases, the exercise of power not being clearly within their office requires some investigation by the other party to the contract. In the case of a sale of a parcel of real property, for instance, where the owner of the property is a corpora-

tion and the sale is not in the ordinary course of the corporation's business, it is the part of prudence to require production of authenticated minutes of the Board of Directors authorizing the officers to effect the sale of the property. The reason for this requirement is that it cannot be assumed that any officer of a corporation has an implied power to dispose of its real property. That power should be reinforced by the resolution of the Board of Directors, the governing body of the corporation.

In other cases, corporate officers and agents are presumed to have power to bind the corporation by contracts which are within the apparent scope of their authority.

REVIEW

State the essentials of a contract.

Explain the importance of consideration.

Is there a difference in the binding force of written and oral contracts?

Distinguish between:

(a) Express contracts and implied contracts
(b) Implied contracts and quasi contracts
(c) Executed and executory contracts
(d) Unilateral and bilateral contracts
(e) Void, voidable, and unenforceable contracts

What rights under a contract has a party who is under age? What liabilities?

Explain the effect of ratification on a voidable contract.

CHAPTER III

CONTRACTS—OFFER, ACCEPTANCE AND CONSIDERATION

1. *The formation of contracts.*—A contract, being an agreement which gives rise to legal rights and obligations, has its inception in an offer made by one party and accepted by the other. When an offer, intended to give rise to a contract obligation, or which the offeree reasonably believes to be so intended, has been accepted, the mutual assent requisite to the formation of a contract is manifested. If the agreement is founded on a legal consideration, the contract is made. As noted in a previous chapter, either offer or acceptance may be express or implied. Contracts vary in their formality, from the written document in which all the terms of offer and acceptance are set out with great particularity, down to the very informal transaction such as that which occurs when a plumber is sent for to fix a leak. But offer and acceptance, in some form, will be found as the genesis of every transaction which the law regards as a contract.

2. *The offer must intend a contractual relation.*—Before proceeding to a discussion of offers, care must be taken to distinguish between the offer which gives

rise to a contract if it is accepted, and apparent offers which are, in reality, only invitations for offers. Advertisements state the prices at which goods are marked for sale, and not infrequently they state the number of articles of a given kind which the store has for sale. A person seeing such an advertisement and dispatching an order immediately with his check would have no right of action against the merchant if the order were not filled. The advertisement is merely a statement of quantity, quality, and price of the goods, for the purpose of inviting the customer to make a purchase. It is not intended as an offer to all the world, subject, through acceptance by an unlimited number of persons, to conversion into an unlimited number of contracts. The same consideration applies to goods which are offered for sale by circular, booklet, or other advertising media.

Very similar to these cases of invitations to deal is the situation which prevails when, as in various lines of trade, a house circulates quotations of prices at which it will buy or sell. If the quotations were to be construed as offers, any buyer might throw the house making the quotation into difficulty by accepting for an amount limited only by the will of the buyer and regardless of the desire or purchasing or selling capacity of the house. A quotation is generally understood to be an indication of the price at which the quoting house will consider an offer to enter into a contract for the sale or purchase, as the case may be. The customer who wishes to deal,

transmits his offer at the quoted price and this offer, upon acceptance, gives rise to a contract. An order given to the house making a quotation, then, is the offer.

An inquiry, of course, is further removed from an offer than is a quotation. It is directed merely to seeking data on which an offer may be made later.

3. *Communication of the offer.*—No offer can give rise to an acceptance, until it has reached the notice of the person to whom it is intended to be made. The ways of transmitting an offer are various —it may be contained in a letter; it may be made by word of mouth; it may be made by telegram or cablegram or wireless; it may be made in the course of a telephone conversation. The essence of the matter is that it come to the notice of the offeree.

The full import of this requirement may be illustrated by a situation where one dispatches an offer by letter to another, offering to sell certain goods of designated quality in a designated amount and at a designated price. By a coincidence, the party to whom the offer is made has already dispatched an order for the exact amount and quality of goods at the named price. Despite the fact that offer and acceptance are identical in terms, no contract arises from this accidental exchange of letters. The letter containing the order was dispatched before knowledge of the offer came to the customer. The customer's order stands as an offer which the other party may accept. It is not an acceptance of the first offer.

4. *The offer must be definite.*—To give rise to an acceptance, making a contract, the offer must be sufficiently distinct and complete so that, when acceptance is made, the essential terms of the contract will be found embodied in the original proposition. If an offer is so indefinite, or so incomplete, that the accepting party must introduce terms, or add terms, we have a case where the original intended offer led to a more complete proposal on the part of the offeree, which now stands as the offer and must be accepted by the first party before a contract will arise.

5. *Options.*—The term "option" is rather loosely applied to transactions which are not alike in nature. Let us take, first, the situation where an owner of goods says that he will give an option on them, for a certain time, to another party. The second party pays nothing, promises nothing, and does nothing in return for this "option." The act is simply an offer on the part of the person giving the "option" and it has no binding force until it is accepted, according to its terms, by the offeree. Until then there is no contract. Contrasted with this we have a true option, which is a conditional promise. The true option requires a consideration, the same as any other contract. Accordingly, when an option is given for a consideration, there is a conditional contract which obligates the promisor to carry out its terms, upon election by the offeree, within the time for which the option was given.

6. *Preliminary agreements.*—Unless a contract falls within the class of those which are required by statute to be in writing in order to be enforceable, an oral agreement has the same binding force as a written contract. The difference, of course, lies in the superiority of proof which the written contract affords. Two parties may come to an agreement that possesses all the elements of a valid contract, intending later to reduce the contract to writing. The contract arises at the time the oral agreement is made and it will be valid whether or not the intent to reduce the contract to writing is carried into effect. In this connection, however, it is necessary to distinguish between cases where the parties come to a definite and final agreement and the contemplated writing has merely the office of a memorandum, and cases where the parties intend the writing to be the final step in entering into contractual relations. In a case of the latter sort, the contract does not arise until the written instrument is drawn and executed.

7. *Continuing offers.*—The most common illustration of a continuing offer is found in an offer of guaranty whereby one party is authorized to extend credit to another up to a given amount, the period for which the guaranty extends usually being stated, and a maximum amount of credit usually being indicated. The guarantor undertakes to pay for the goods purchased if the customer does not. Acting under the guaranty, there may be frequent extensions of credit. The guarantor may revoke the offer

when he chooses, but, as to the credit previously extended, in accordance with its terms he is bound by his guaranty, for each extension of credit was an acceptance in so far of the guarantor's offer, and in so far provided consideration for the promise of guaranty. Unless revoked, the offer continues open during the indicated period.

8. *Acceptance.*—Before an offer can give rise to a contract, it must be accepted. The acceptance must be that of the person or persons to whom the offer is addressed. The offer is subject to acceptance only by those to whom it has been communicated. An offer may be broadcast for acceptance by anybody who, with knowledge of the offer, may comply with its terms, as in the case of advertised promises to pay a reward for information, or the performance of an act.

To give rise to a contract, the acceptance must conform with the offer. If a specific method of acceptance is prescribed, that method must be observed. If the offer, by its terms, is limited to a specific time, the acceptance must be made before the expiration of the period for which it holds good. If the acceptance is required to be communicated to the offerer at a certain place, compliance with the condition is a prerequisite to the formation of the contract. The acceptance, furthermore, must meet all the terms of the offer, and it must not change those terms or introduce conditions or terms not contained in the offer. An acceptance that attempts to vary the terms

of the offer, or to introduce new matter into the negotiations, does not transform the offer into a contract, but, on the contrary, effects a rejection and termination of the offer. We may summarize by saying that the acceptance is required to be unconditional and, in its terms and meaning, identical with the proposal which it purports to accept.

9. *The acceptance must be overt.*—Just as the offer must be communicated in some way to the offeree before the state of affairs permitting an acceptance can arise, so the acceptance of the offer must be by an overt act. Mere silence or failure to act is very rarely the equivalent of acceptance. If goods are shipped to a person without his previous request, but he knows that they are not intended as a gift, their retention and use will give rise to an implied contract to pay for them. But it is the retention and use, rather than silence, which constitutes the acceptance. Acceptance may take the form of written or spoken words, whereby the terms of the offer are formally agreed to by the person to whom the offer is made, or it may take the form of an act, or course of acts, showing that the offer has been accepted.

Whether, in any given case, acting upon an offer will be a sufficient acceptance, will depend chiefly on the nature of the transaction and the intent, actual or presumed, of the person making the offer. Two persons may hold several conferences to discuss the matter of one acting as agent for the other in some projected transaction. Substantial agreement as to

terms and particulars is reached and the principal dispatches a letter to the other party reciting the substance of their agreement and stating that he will employ the addressee as agent upon these terms. The letter is written in duplicate, and the original and a copy are inclosed, both containing the single word "Accepted" at the bottom with a line for the signature of the agent. Here the intent of the principal is clearly to make an offer which is to be accepted by the appending of the agent's signature and a transmittal of a communication of acceptance to the principal before the relationship shall come into effect. If the agent, without signing and returning one of the duplicate letters, or otherwise communicating with the principal, enters upon the performance of the projected duties, he does so at the risk of having the relationship repudiated by the principal. On the other hand, a business house may address a letter to another house ordering the shipment of certain goods at a price previously quoted by the house to whom the letter is addressed. Unless the letter intimates that a communication of acceptance is desired, or unless the previous course of dealings between the parties has made a confirmation of such orders usual, the house receiving the order may proceed to fill it, and its act in shipping the goods in accordance with the order constitutes a sufficient acceptance of the offer to purchase.

The rule may be summarized as follows: Ordinarily, the acceptance must be communicated to the

person making the offer and, if a particular method of communication is prescribed, that method must be followed. If the offer, by its terms, states, or if the customary dealing between the parties has been such as to indicate, that a communication of acceptance is not relied upon by the person making the offer, then acts which are taken in pursuance of the offer may constitute an acceptance.

10. *Acceptance of written instruments.*—When a person accepts a written document to which his signature is not necessary, in the course of a commercial transaction, he is bound by its terms, whether or not he intended to enter into such a contract. An exception should be mentioned, which is that, in some cases, it has been held that the terms must be sufficiently called to the attention of the person receiving the written instrument and not tucked away or hidden so as to make the instrument appear to be one thing on its face, and another thing when the material printed in small type or in another part of the instrument is taken into consideration. An example of being bound by the terms of a written instrument, accepted but not signed, is found in the case of a deed containing a covenant on the part of the grantee to assume and pay an existing mortgage on the property.

The rule applies with even more force to cases where parties sign a contract without having read the instrument through, or without understanding all of its terms. A person is bound, presumptively, by the

terms of a contract he has signed. This presumption can only be overcome by proof of fraud which induced the party to sign without reading.

The reason for these rules is evident. When the parties take the trouble to have a contract drawn, the presumption is that they also take the trouble to see that the contract is drawn in accordance with their understanding and that it contains no provisions contrary to their agreement. The party who accepts a written document without taking the trouble to read it to make sure that this is so must abide by the result of his own negligence.

11. *Acceptance by mail.*—There is an apparent exception to the rule that acceptance must be communicated in the case of acceptances dispatched by mail. The offer must reach the offeree—otherwise, there is nothing he can accept. Suppose he decides to accept the offer. The case being one where acceptance by mail is called for, or is usual, he writes his acceptance and mails it, properly addressed and stamped. When the letter has been posted in the post office, or in a mail box, the offeree has done everything within his power to accept the offer. If his acceptance fails to reach the offerer, the blame is attributable either to the mail service or to someone, possibly in the employ of the offerer, who mislays the acceptance upon its receipt.

The law does not cast upon the offeree the burden of responsibility for mail service, or for the acts of the offerer's employees. When he has posted his

acceptance and the matter has passed out of his hands, his acceptance is effectual and a contract is made, even though it never reaches the offerer. Of course, the difficulty will usually lie in proof of the posting. When a transaction is such that proof of the mailing of the acceptance may become important at a later date, care should be exercised to see that actual knowledge of the mailing of the particular acceptance is had by two or more parties who can attest the fact later.

12. *Termination of offers.*—No offer, unless expressly so stated, remains open indefinitely. There are various ways in which it may be terminated before acceptance. It may be ended by:

(a) The lapse of time
(b) Death of one of the parties
(c) Rejection in whole or in part by the person to whom the offer is made
(d) Revocation of the offer before it has been accepted

These methods of terminating offers will be considered separately below.

13. *Termination by lapse of time.*—An offer may be made to hold good for some specific period, or it may be indefinite as to time. Few difficulties are presented by the former situation. If an offer, by its terms, provides that it must be accepted within 30 days, the mere expiration of that period puts an end to the offer and no acceptance thereafter would be effectual. As to offers which are not made for a specific time, no general rule can be laid down. The

most categorical statement is that every offer must be accepted within a time which is reasonable, considering the nature of the offer and the circumstances under which it is made.

There are cases in which the entire circumstances suggest that an immediate reply is expected, and here a delay of 24 hours, or possibly less, would serve to terminate the offer. Other transactions, in which no such pressing need of a reply is indicated, would permit a longer time for the offeree within which he may decide whether to accept or not. The period may range from days to months, again in accordance with the circumstances of the transaction, the nature of the business deal, and the influence of an established course of dealing between the parties, or established customs in the trade.

14. *Termination of offer by death.*—Death of either party, before acceptance, terminates the offer. This is so whether or not the other party knows of the death.

15. *Counter offer.*—It has been noted above that acceptance must be in accordance with the terms of the offer and that it must not vary the offer, or introduce new elements. When the person to whom an offer is made purports to accept it, but, in so doing, introduces variations, or modifications of the offer, or adds terms and conditions not contained in the offer, the effect is to reject the offer that started the proceedings. The acceptance that so modifies, changes, or adds to the original offer, now stands as a fresh

offer made by the second party and, in order to give rise to a contract, must be accepted by the original offerer. This situation affords an illustration of the termination of an offer by act of the offeree.

16. *Rejection of offer.*—In the preceding paragraph, the termination of the offer may have been inadvertent. The offeree may have intended to accept, but he may not have been aware of the fact that introduction of other terms constituted a rejection. A second class of cases where the offer is terminated by the offeree is, of course, those where there is an explicit or an implied rejection of the proposal, in whole, or in part. A positive rejection puts an end to the offer and it is not revived by anything the offeree can do, if he changes his mind. There must be a fresh offer after his rejection of the original proposition.

17. *Termination of offer by revocation.*—We have now to consider the termination of offers by the acts of the offerer. An offer may be revoked at any time before its acceptance. This is so, irrespective of whether the person making the offer has said he will keep it open for a definite length of time, or not. In order to make revocation effectual, notice must come to the knowledge of the person to whom the offer was made. The simplest and safest procedure in cases of revocation is to dispatch written notice to the offeree, though notice in any form suffices.

The doing of acts inconsistent with the continuation of the offer, which acts come to the knowledge of

the offeree indirectly, constitutes an implied revocation. Thus, if an offer has been made to sell a specific thing, and before a reasonable time for acceptance has elapsed the offerer sells to another party, and knowledge of the sale comes to the offeree indirectly, the offeree, though a reasonable time for acceptance has not elapsed, cannot by attempted acceptance convert the offer into a contractual promise.

It is generally held that notice of such an inconsistent act coming to the offeree indirectly, but in such manner that a reasonable man would not act upon the offer as continuing, without further inquiry, is tantamount to direct revocation.

Since it is required that knowledge of revocation be communicated to the offeree, it follows that, in the case of a direct revocation, the offer is not terminated until the letter, telegram, or other message actually comes into the possession of, or to the knowledge of, the offeree.

18. *Consideration.*—A contract under seal, because of the formality of its execution, requires no consideration at common law, and this rule still obtains in some jurisdictions. In others, the rule has been so modified as to provide that consideration is presumed in cases where the contract is under seal. The presumption may be rebutted, however, that is to say, may be overcome by showing that in fact the offer was gratuitous.

Every simple contract requires a consideration. As mentioned in the preceding chapter, the consid-

eration for an act or a promise may take a variety of forms. The essence of consideration is that the promises of the parties shall not be gratuitous—that sufficient inducement be found in the acts or promises of the other party for the act or promise of the first party.

When the various forms which consideration may assume are grouped, it will be found that every consideration results in one of two things, or a combination of them. Either the party from whom the consideration moves suffers a detriment, or the party to whom the consideration moves receives a benefit, or both of these things occur. To illustrate: In the case of a money payment forming the consideration for a promise, the promisor is benefited by its receipt and the promisee suffers a detriment by his payment, in the sense that he gives up something which he is under no legal obligation to give. Whenever a promise is made, or something is done, given, or forborne by one who is under no legal obligation so to do, a consideration exists for the promise given him in exchange. Thus, in general, consideration may be summed up as being anything which is of legal benefit to the promisor, or which is of legal detriment to the promisee. Obviously, either of these conditions is sufficient to make the promise something more than a mere gratuity.

19. *Amount of the consideration.*—The law requires that a contract, to be binding, must be founded upon a consideration, but the law does not endeavor

to make contracts for parties. Whether the consideration is adequate in any given case is a business matter and not one that goes to the legality of the contract. A consideration of one dollar is sufficient to support a contract for the transfer of property of an amount considerably greater in value.

20. *Promise repeating an existing obligation.*— While the law will not inquire into the amount of consideration, except where the rights of third parties are involved, it will inquire into the reality of the consideration. Such cause for inquiry arises in cases where there is a promise to do some act that the promisor is already obligated to perform. A creditor, for instance, may agree with his debtor to extend the time for payment. The forbearance of the creditor to insist upon payment at maturity would be consideration for the debtor's promise, but where is the consideration for the creditor's? The creditor receives only the promise of the debtor to pay his debt at the extended maturity. But the debtor was already bound to pay and the creditor receives no benefit, nor does the debtor suffer any detriment from the extension. The creditor's promise in this case is clearly gratuitous. The debtor has merely agreed to do something he was already bound to do.

Unless the parties have otherwise agreed, a real estate broker earns his commission when he has produced a party ready, willing, and able to buy, and the contract of sale has been made. Let us assume that he agrees to waive immediate payment of his

commission and to wait until title passes. He is not bound by this agreement, for the vendor's agreement to pay the commission at a later time imposes no detriment upon him and gives the agent no rights he did not already possess.

In all cases where the consideration rests, apparently, in the doing of some act, or in forbearing to do some act, by one party, this question should be asked: "Does the performance of the act, or the forbearance, cause this party to do something, or to refrain from doing something, to which he was not previously bound?" If it does, there is a presumption of consideration. If it does not, there is the presumption that consideration is wanting. This fact is so whether the fresh promise is a repetition of an obligation already owing to the party to the intended contract, or whether it is a reaffirmance of an obligation due to a third person.

21. *Forbearances to sue.*—Cases that involve an agreement on the part of one party to refrain from bringing a legal action fall into several classes, as far as reality of consideration is concerned. In the first place, there must be a valid cause of action. A person obviously suffers no detriment from refraining to bring suit on a pretended, or groundless, claim; and his promise to refrain from bringing an action of this sort would not be consideration. If, on the other hand, there is a right of action which is well grounded, the person who has a right to bring it suffers a detriment by not suing, and his refraining from suit, con-

sequently, is consideration. The same condition holds true if there is a reasonable and probable ground for bringing suit, for, obviously, the result of no action can be determined definitely in advance. The requirement merely is that it shall be a reasonable cause of action and not a pretended cause.

When an action has been prosecuted to the state of judgment, an agreement to pay the judgment by the judgment debtor would be no consideration for a promise made by the judgment creditor to delay pressing it to execution. The reason is that indicated above. The judgment creditor already has an enforceable claim against the debtor, and the debtor's fresh promise to pay adds nothing to the creditor's security, and the judgment debtor suffers no detriment through making it.

22. *Past consideration.*—An act or forbearance, or a promise, to constitute consideration must be coincident with the promise that it is to support. A consideration already received is not sufficient to support a later promise to pay. The illustration usually cited is that in which one party performs gratuitous services for another. The beneficiary of the services is not bound to pay for them. A later express promise to pay for the services gratuitously rendered in the past will not give rise to a contract that can be enforced against the promisor, the past services affording no fresh inducement for the present promise.

This rule does not result in denying effect to a fresh promise made by an infant after attaining his

maturity, intended to ratify a contract to a suit on which the defense of infancy might be interposed, or to a fresh promise made by a debtor, a suit on whose debt has been barred by the Statute of Limitations. No fresh consideration moves in these cases and, apparently, there is nothing to support the new promise. But such promises are enforceable. The debtor has been benefited by a rule of law, or statute, which afforded him a defense to an action but did not extinguish his obligation, and it is held that he may waive this defense; that his promise acts as such waiver; and that a waiver of defense requires no consideration.

23. *Compromises.*—A true compromise occurs, when the amount of an indebtedness as between parties is not fixed and certain, and they reach an agreement whereby a definite amount is fixed which is to be paid and accepted as a full discharge of liability. In the case of the true compromise, there is consideration. The promise to pay the fixed amount is sufficient consideration for the creditor's forbearance to endeavor to collect the larger amount which he claims to be due. A different rule applies in cases where the debt is certain in amount. Here, the promise of the debtor to pay a lesser amount than that which is claimed, and which is definitely due, obviously confers no benefit upon the creditor, nor does it impose any detriment upon the debtor. A compromise of this sort, then, fails because of lack of consideration.

It would be otherwise, however, if the agreement and payment were made before the debt became due. Here the debtor is paying before he is under obligation to pay, suffering a detriment, and the receipt of a smaller sum in the present may well be worth more to the creditor than a larger sum in the future.

24. *Composition.*—When the affairs of a debtor become involved, a composition with creditors is an agreement which may be reached for the discharge of his obligations by the payment of less than the several amounts due, or by extension of payments over a period of time. The consideration to each individual creditor who enters the compromise may be found in:

(a) The forbearance of other creditors to press their claims, the circumstances being such that forbearance is for the benefit of all
(b) In the endeavor of the debtor, and his accomplishment of that endeavor, to obtain the agreement of other creditors to forbear

Compositions of this sort are sustained, consideration for the mutual undertaking of debtor and creditor being found upon the grounds noticed.

25. *Consideration presumed.*—It has been noted that, in many jurisdictions, when a contract is under seal, consideration is presumed. A similar presumption exists in the case of negotiable instruments, such as bills of exchange and promissory notes. As between the immediate parties—maker and payee—the presumption may be overcome by the maker's proving

want of consideration. Against a holder of such a negotiable instrument, to whom it was indorsed and delivered for value, before maturity, and without knowledge of want of consideration, and as against one who derives his title through such a holder, the defense of want of consideration cannot be successfully set up.

26. *Cases of agreements enforced though lacking consideration.*—There remain for discussion those cases in which agreements, lacking consideration in the sense heretofore described, have been held enforceable on the ground of estoppel. In this class of cases, there is not a reading of consideration into a contract where no consideration exists, but the circumstances are said to preclude, or estop, the taking advantage of the fact that consideration is lacking. An instance of this type of cases is afforded by the promise of a debtor that he will not avail himself of the defense of the Statute of Limitations. Where the parties enter into a contract whereby the creditor promises to delay his suit, and the debtor promised not to plead the Statute, we have a clear case of consideration, each promise being a detriment to the party making it.

The type of case under consideration, however, is illustrated by the case of a debtor who says he will not plead the Statute, and the creditor, relying upon the debtor's statement, refrains from pressing his claim although he does not by promise undertake to do so. Apparently, true consideration is absent from

this transaction. But cases have been decided holding that, in these circumstances, the debtor will be precluded from later availing himself of the defense.

In the same way, a creditor may inform a debtor that performance of the debtor's obligation at a future time, when it matures, will not be insisted upon. If, relying upon the statement of the creditor, the debtor does not arrange his affairs to make the payment, the creditor will not be allowed to take advantage of the situation by enforcing, say, a foreclosure, as in the case of a mortgage, or a revocation of the lease, as in the case of the covenant to pay rent. The debt, of course, remains. But taking advantage of non-payment to enforce a penalty, or forfeiture, is barred.

27. *Estoppel the basis of these decisions.*—The ground for the court's position in this class of cases is traceable to a variant of the equitable doctrine of estoppel. Estoppel, in brief, means that equity will not suffer a person, who, by his positive act, or his negligent or willful forbearance to speak or act, has led another person to a given course of action, to take advantage later of the rights he might have asserted before the second party so acted. To bring a case within the operation of the doctrine it is essential:

(a) That the party to whom the statement is made could, and probably would, have taken a definite course of action, except for the gratuitous promise

(b) That he acted in reasonable and justifiable reliance upon the gratuitous statement

(c) Repudiation of the gratuitous promise would result in damage to him

REVIEW

Distinguish between an offer intended to create a contractual relationship and an offer which is an invitation to deal.

Explain the effect of an acceptance that introduces new terms, or modifies the terms of the offer.

What procedure governs acceptance? Explain how an act can be the equivalent of acceptance.

What is the force of parts of a written instrument not read by a party but signed or accepted by him?

Show how a contract may arise although the acceptance does not reach the offerer.

State how offers are terminated. What acts amount to rejection of an offer?

Must revocation of an offer be communicated to the other party?

Cite two instances of promises which are not sufficient consideration because they do not change the status of the parties.

State the theory of compositions and compromises.

On what doctrine are some agreements enforced when consideration, in the legal sense, appears lacking?

CHAPTER IV

CONTRACTS—FORM AND ASSIGNMENT

1. *Form of contract.*—As we have seen, a contract may arise from oral agreement of the parties, and, for contracts which do not fall within the specific classes now to be discussed, such a simple agreement will be sufficient. As long ago as the reign of Charles II in England, however, experience indicated that more than a simple oral agreement should be required in certain classes of contracts. Contracts of these classes involve those peculiarly susceptible to difficulties of oral proof and those in which, from the nature of the transaction, it is desirable that the greatest degree of certainty be present. The Statute of Frauds, enacted by Parliament early in this reign, required, accordingly, that the classes of contracts therein enumerated should not be enforceable unless they were in the form prescribed. This form, generally, is that of a writing signed by the party to be charged, although, in the case of sales of goods, payment of part of the purchase price by way of earnest money, or delivery and acceptance of all or part of the goods sold, might take the place of a written contract.

This statute has been reënacted in substance in

every state of the Union. The purpose, as the title implies, is to insure, so far as possible, against fraud by requiring proof in definite form. It is to be noted that an oral contract falling within any of the specified classes is not void. Parties may agree verbally to the transfer of real property (this being one of the classes requiring a written contract), and, if the agreement is carried out, the conveyance ends the matter. But a contract which falls within any of the classes mentioned in the statute is unenforceable in a court of law, unless it meets the statutory requirements. Since the adverse contingency is always the one to be guarded against, and since nobody wishes to have a contract on his hands which he cannot enforce, if the necessity of taking action should arise, it is of as great practical importance to comply with the requirements of such statutes as though such contracts were deemed void.

2. *Contracts required to be in writing.*—At this point, we shall consider the main rules of the statutes which require certain classes of contracts to be in writing. The provisions which deal with specific classes of contracts that are discussed in other chapters will be treated later. Thus, the requirements as applied to contracts to answer for the debt, default, or miscarriage of another will be taken up in the chapter on security, and those relating to sales of personal property will be taken up under that title.

3. *Contracts not to be performed within a year.*—A contract that is not to be performed within the

period of a year from the time it is made is unenforceable under the Statute of Frauds, unless it is in writing. In determining what contracts fall within this class and what contracts do not, the determining factor is the answer to the question, "Is it possible to perform it within a year?" If it is impossible to perform it within a year, according to the terms of the contract itself, the agreement falls within the class required to be in writing. If, however, it can be performed within a year, the contract is held not to fall within the statute, even though performance within a year is improbable.

As an illustration, the case may be taken of a contract to erect a building which requires completion in 18 months' time. It may be somewhat improbable that the building can be completed in much less than 18 months, but it is possible that, in an emergency, it can be built inside of a year. Since it is possible to perform within a year, the contract is held not to fall within the class required to be in writing. Contrasted with this is a contract of employment whereby a person is hired for a period of two years. Obviously, this contract cannot possibly be performed in less than two years' time and, consequently, it must be in writing in order to sustain an action at law upon it.

In every contract in which performance is to extend over a longer period than a year, the question should be definitely asked and answered whether, in accordance with its terms, the contract can be per-

formed in less than a year's time. If the answer to this question is in the negative, the requirement of a writing applies.

4. *Contracts not to compete.*—A contract not to compete, unless specifically limited to a year's time or less, is required, by the weight of authority, to be in writing. The only way in which such a contract could extend for less than a year would be by the death of the party entering into the agreement. Some courts take the view that, in this event, the contract would be fully performed within a year and, hence, is not required to be in writing. This line of reasoning would apply with equal force to other classes of contracts, such as those of employment, which are the very cases to which the statute is meant to apply and would render the statute inapplicable to the most important groups of cases. The courts in a majority of the states, consequently, hold that such contracts must be in writing. The death of a party does not actually accomplish a performance of the contract; it merely discharges the obligation by making performance impossible.

5. *Method of performance.*—As stated above, the general rule is that, if a contract can be performed within a year, it does not fall within the statute. But emphasis is also laid upon performance according to the contract's terms. Thus we may have a contract that is possible of accomplishment within a year but in which the parties have outlined a certain method of performance that will extend beyond a year. In

this case, it is evident that, if it were not for the contract's specification of a mode of performance, we might have an agreement which would not fall within the statute. But since the contract itself provides a method of performance which cannot be accomplished in a year, it is brought directly within the statute requiring a writing.

We now turn from a class of cases in which time of performance is the element to a class of cases where the Statute of Frauds requires a written contract, regardless of time of performance, if the subject matter brings it within the purview of the act.

6. *Contracts in consideration of marriage.*—The Statute enacts that, when the consideration of a contract is marriage, the agreement must be in writing and signed by the party to be charged. The most usual agreements of this sort are those providing for a marriage settlement, or agreement by a wife to relinquish dower rights. These are directly within the statute and must be in writing. The statute has no application, however, to contracts to marry.

7. *Contracts for the transfer of an interest in land.*—An important section of the Statute of Frauds—important because such transactions are frequent and often involve large sums of money—is that requiring contracts for the sale of, or concerning an interest in, real property to be in writing. It is because of this requirement that every sale of real property has, as its first step after the parties have reached their agreement, the execution of a written contract em-

bodying the terms of the agreement and signed by buyer and seller. Of the same nature are contracts requiring the execution and delivery of mortgages of real property, and contracts for the grant of easements.

When we come to leases, a different situation obtains, because a leasehold estate for years, while giving the lessee the use of real property, is considered merely a chattel interest in land. Specific and varying provisions are found in various states with regard to the requirement of writing for leases. In some states, a lease for a term of more than one year is required to be in writing and signed by the lessor or his agent. In others, the period is longer.

One more contingency with regard to leases is that of a lease which is to become operative some time in the future. Take a state in which leases for more than a year are required to be in writing, and assume that property is leased for one year, the lease to commence, however, three months hence. The leasehold term is not for more than one year. It will be 15 months, it is true, before the term ends. But this does not bring it within the section requiring contracts to be in writing that cannot be performed within a year. This contract is performed by the landlord when the lease is made, and the tenant may perform within a year by paying full rent for the term.

A license for the use of real property not amounting to a grant of an easement is a type of contract

that does not transfer an interest in real property and, consequently, need not be in writing. Such a license is illustrated by an agreement between adjacent property owners whereby one neighbor is permitted to use another's driveway. Such a license, which is a mere permission, creates no interest in real property. The permission is personal to the licensee.

8. *Assignment of contract.*—In the early days of the common law, the assignment of rights under contracts was not regarded with favor. The right was regarded as something personal and, consequently, to be enforced only by the original party to the contract. The requirements of a more complicated and more swiftly moving commercial life have brought about modifications of this ancient rule. At the present time, there is considerable latitude in the assignment of rights possessed by virtue of contract.

In the course of its development, the law passed from a stage in which rights were not assignable to a stage where they were assignable, but the assignee had to sue in the name of the assignor—the original party to the contract. The assignee, although it may have been the intent to transfer rights entirely to him, was still regarded as merely the agent of the original party. A survival of this period of the law is found today in the rule which holds that an assignee receives his rights subject to any and all defenses that existed against the assignor before the assignment was made. The requirement that a suit be brought in the name of the assignor has now given

way, generally, to recognition of the assignee as the real party in interest, entitled, and in fact required, to sue in his own name. It is to be noted here that what has been said regarding assignments of contract rights has no application to the indorsement and delivery of negotiable instruments, a subject that is considered later in this Text.

9. *Rights that may be assigned.*—We may now consider what rights in general may be transferred by assignment. In the first place, rights that have already accrued under a contract are held to be assignable. Thus, a party who has payments due and owing to him under a contract, or who has a claim for damages arising out of a breach of contract, may assign his right to payment or damages. A second class of rights that are freely assignable consists of rights to receive payments under a contract that is in existence at the time the assignment is made. Thus, with a contract in existence, a party may assign the rights to payments already due and to payments that are to become due under it. The law interposes a limit, however, as to the future rights that may be assigned. Regarding it as against public policy to permit one to assign away all possible future benefits, an assignment of profits or wages, which it is expected will be due under a contract not as yet made is held to be inoperative.

Since payments may be assigned, it follows that the right to receive property may also be assigned. Consequently, a vendee who has entered into a con-

tract to buy real estate may assign his interest in it, and the same right applies in the case of contracts where personal property is to be obtained. The tendency of the law is to make contracts freely assignable, unless the personal equation enters or the contract contains a specific prohibition against assignment.

10. *Contractual rights that may not be assigned.*— In addition to prohibiting the assignment of future or prospective payments under contracts not yet in existence, the law does not permit an assignment if the contract is one in which the personal element centers so that the reputation, skill, integrity, or confidence of one party has obviously been taken into account in entering into the contract. These are qualities that cannot be transferred to another— hence, rights of performance cannot be transferred. An employee, for example, cannot assign his rights under an employment contract to another, for, if a contract of employment exists, there has obviously been consideration of the employee's personal qualifications, making it impossible to substitute another employee without some injustice to the employer. In the same way, if there is a personal element involved, the employer cannot assign his part of a contract. The same rule obtains in the professional field for reasons, if anything, more cogent. In all of these cases, rights to receive payment after the payment is due, or future wages, may be assigned, since the collection involves no personal element.

It is not always easy to determine when a contract involves a personal relationship, or depends upon the personal confidence of one party in the skill or experience of the other. A person who has engaged a painter to paint his portrait cannot assign the right to another sitter to have his portrait painted; nor can the painter assign his rights to paint the portrait to another artist. A building construction contract is also held to be non-assignable on the ground that the owner relies upon the reputation, skill, and knowledge, as well as the pecuniary responsibility of the contractor. But when the service is purely mechanical, such as the excavation of a cellar, the rule is that the contract may be assigned, because the question of skill or particular knowledge did not presumably enter into the minds of the parties, and was not an essential factor in creating the contract relationship.

11. *Liability of assignor.*—While a contract not involving the personal element may thus be assigned, the assignor cannot rid himself of all responsibility. Otherwise, the other party to the contract might be left damaged by non-performance and without any rights against the original party with whom he contracted. The law says, in effect, that while the assignor may transfer his rights, he cannot be completely absolved from responsibility. Hence, if the assignee who is to perform fails in his undertaking, the assignor may be held liable for the breach as if he were personally in default. The reason is embraced

in the statement that rights may be assigned but duties cannot be assigned. They can only be delegated. The only way in which an assignor may relieve himself of his obligation is by a *novation.* A novation is a new contract by which the other party releases the assignor from his obligations and agrees expressly to the assignee's assumption of those obligations.

12. *Effect of prohibiting assignments.*—A contract may be made non-assignable by its terms. If such an agreement is made by the parties, it will be given effect, the express agreement overruling other considerations. When provisions forbidding assignments are found, they are present usually because of circumstances peculiar to the class of contracts in which they are employed. Insurance contracts are made non-assignable because the contract is personal and an assignment would substitute another and different risk for the known risk assumed by the insurance company, and one that might not be as satisfactory as the one originally insured. Contracts for the sale of real estate are sometimes made non-assignable. Because of the greater freedom in assigning contracts, which the law now permits, an express prohibition of assignment should be included in any contract where it is desired that performance be done by, or be rendered to, the party with whom the contract is made, and by and to him only.

13. *Distinction between assignments and drafts.*—An order for the payment of money, such as a draft,

or check, calls for payment of the amount specified to the payee. A draft may be an assignment, or not, according to the circumstances of the case. A check is not an assignment. It is an order directed to the bank, drawn on funds which are on deposit, but against the general credit of the maker of the check. The bank must honor the check if the depositor's funds are sufficient; it may honor the check if they are insufficient. Similarly, in the case of the ordinary commercial draft or bill of exchange, the holder has received not an assignment of any specific funds, but an order to the drawee to pay out of such funds as are in his hands. A different situation is presented, however, when an order is given for payment out of a specific fund, or part of such a fund. For instance, a building contractor may give an order directing the owner to pay all, or part, of some future installment to become due under the contract to the party to whom the order is given. This is clearly an assignment and not a draft drawn on the general credit of the contractor with the owner of the property.

14. *Form of assignment.*—Contracts for the sale of land, as we have seen, must be in writing, and an assignment of such a contract must also be in writing, because it is not only an assignment but a transfer of an equitable interest in the land that the assignor has acquired under the contract. The assignor, however, is the only one who can question the validity of the assignment. As against the seller, an oral assignment will be good. Assignments of leases for years

are required to be in writing in many jurisdictions, but, in New York and many other states, this requirement is instituted only in the case of a lease to run more than a year.

With the above limitations in mind, the general rule is that assignments need not be in writing, unless a local statute so provides. This condition is true even as to the assignment of an instrument under seal, except in Massachusetts. In that state, an assignment of such an instrument must also be in writing and under seal.

As a practical matter, it is always best in the matter of assignments, as in other business arrangements, to put them in writing, whether the law requires it or not. The proof is then more certain.

15. *Defenses of the debtor or obligor.*—As was pointed out in a previous section, an assignee takes the assignment of a claim subject to all defenses which the debtor or obligor could set up against the assignor. If the contract assigned was obtained by fraud or duress, or if the debtor's promise was without consideration, he can use these and like defenses against the assignee. If the local law permits the debtor to set off against the assignor counterclaims of his own in an action between them, the debtor may likewise set off, or counterclaim, against the assignee any debts or obligations that arose in his favor against the assignor before the assignment was made. Suppose, for example, that A owes B $1,000. In another transaction B owes A $300. Subsequently, B

assigns his $1,000 claim to X. X could require A to pay him only $700, since A would be allowed to set off against X, the assignee, his claim against B, the assignor.

16. *Effect of notice.*—After a debtor has received notice of an assignment, he cannot pay to anybody except the assignee, without incurring possible double liability. If he pays before notice of the assignment, however, he will be protected and, on the same principle, a release of the debtor before notice to him of assignment will be a good defense, but not a release after notice.

17. *Contracts for the benefit of third persons.*—It has been noted that there are cases in which an assignee, who is not a party to the contract, can enforce claims arising out of it, although the general rule is that only the parties have legal rights thereunder. In the case of contracts in which performance is for the benefit of a third person, the general rule, to which there are exceptions in England, Massachusetts, and some other jurisdictions, is that the third person may enforce the contract, although not a party thereto. This majority rule is in consonance with the intent of the parties when the contract evidences that the promise secured for the third person's benefit was not intended as a mere gratuity, but as part of a business transaction.

18. *Third person as sole beneficiary.*—One class of contracts which most jurisdictions will enforce for the benefit of the third person is that in which the

sole benefit from performance of the contract is received by the third party and no benefit accrues to the party securing the promise. A life insurance policy affords an illustration. The premium payments form the consideration for the promise of the insurance company to pay the designated amount to the stated beneficiary. Here it is obvious that the beneficiary is the only party intended to be benefited through the insurance contract, and he is the only one who could show damages if the insurance company were to break its contract. As a consequence, it is obviously intended by the parties that he shall have the right to enforce it. The beneficiary of an insurance contract is permitted to enforce it even in those jurisdictions that do not otherwise permit a third-party beneficiary to recover on claims that arise out of contracts.

19. *Creditor as the beneficiary.*—Another class of cases, in which the position of a third party comes into question, is where the contract calls for the payment to a third person of a debt owing to such third person by the party securing the promise. As an illustration, take the case of A who is in debt to B for $300. The debtor then, as part of a contract with C, obtains an undertaking from C to pay the $300 to B. It is held in cases of this type that the creditor, B, may enforce this promise even though he is not a party to the contract.

In cases of this variety, it is requisite that two things appear:

(a) That the person who secures the promise from the third party owe some debt or obligation
(b) That the parties intend the promise to benefit the third person and evince an intent that he shall be able to enforce it

20. *Assumption of mortgage debt.*—A common illustration of such a contract is found in the case of agreements by a purchaser of real property to assume and pay a mortgage debt already existing. Because of the existence of the mortgage, the purchaser pays less in cash, and, if he promises to assume, and agrees to pay the mortgage as part of the consideration for the transfer of title, it is clear that both he and the vendor intend that the mortgagee shall look to him as the primary debtor, and that the mortgagee shall have the right to enforce the promise. The intent of the parties is recognized by the courts and the party who assumes the mortgage in this case is considered the primary debtor, with the vendor of the property as surety for the debt.

21. *Absence of debtor-creditor relationship.*—If, however, the person who secures the promise in any of these cases owes no debt or obligation of any kind to the third person, the third person cannot obtain the benefit of the promise. Thus, if a man buys property subject to a mortgage, but does not assume to pay the mortgage debt, and thereafter conveys the property to another and exacts from him a promise to pay the debt, the latter's promise will not be enforceable by the mortgagee. The first requisite

to make such a promise enforceable is lacking—there is no debt or obligation owing from the person securing the promise to the third person beneficiary.

22. *Incidental rules.*—The creditor beneficiary is not obliged, of course, to adopt the promise made for his benefit. He may prefer to enforce his right against the original debtor. If he chooses to act upon the contract made for his benefit, and shows his adoption of it in some definite way, the parties to the contract cannot thereafter defeat his right by a rescission or a release. On the other hand, the beneficiary, in all cases, takes his right subject to defenses that the promisor would have if the person who had secured the promise brought the action. Such defenses are lack of consideration for the promise, fraud practiced in obtaining the promise, etc. In short, the contract in favor of the third person must have been a valid one as between the parties, to enable the beneficiary to enforce it.

REVIEW

What is the purpose of the Statute of Frauds?

Explain its provisions regarding contracts not to be performed within a year, and their interpretation.

Does an agreement to give a mortgage come within the Statute of Frauds?

What contracts may be assigned and what contracts are not assignable?

Give an example of a defense that might be used by an obligor against an assignee, and of a set-off that might be so used.

State the requisites of an enforceable contract for the benefit of a third party.

CHAPTER V

CONTRACTS—PERFORMANCE AND DISCHARGE

1. *Performance.*—Performance of a contract is required in accordance with its terms. Unless performance is excused by the other party, a failure to perform renders the party in default liable to pay damages for his breach. The questions which arise regarding performance of contracts are chiefly:

(a) Those involving interpretation of the contract's terms
(b) Those arising from conditions in the contract

Conditions in contracts may be implied from the circumstances of the case; they may be implied by law; or they may be written into the contract for the benefit or protection of a party. Since questions of performance relate principally to the effect of conditions on liability to perform, we must first consider different types of conditions. Conditional promises fall into several classifications which will be considered more fully below. Absolute promises give rise chiefly to questions of interpretation of terms and to questions of fact as to performance.

2. *Express conditions.*—Conditional promises are very frequently found in contracts. A party, by the

very terms of the contract, may make his performance dependent upon any event or contingency as long as the condition is not illegal or impossible of fulfillment. In such case, the condition is said to be express.

The event upon which performance is conditioned may be within the control of a party or parties, or it may be entirely outside their control. Fire insurance contracts are an instance of the latter type. In these contracts, the insurance company is the promisor and performance of its promise is conditioned on the occurrence of damage or destruction by fire. Such policies also illustrate conditions that are under the control of one or more of the parties. They prohibit the keeping of more than limited amounts of gasoline and other inflammable substances upon the insured premises. If this condition is broken, it is broken by the act of the insured, and a material breach is sufficient to release the company from liability.

The same act may be the subject matter of one promise and the condition attached to another. In a contract between A and B, a ship owner, for the carriage of goods, payment of freight might be conditional upon safe arrival at the port of destination. The safe carriage is the subject matter of B's promise and it is also the condition precedent to A's liability.

In cases like the foregoing, the condition is expressly set forth and performance by one party of

his promise is expressly made to depend upon fulfillment of the condition. The conditions are thus both express and precedent to liability of the other party, whence their name of express conditions precedent.

It is apparent, from the above, that one party to a contract may be discharged from performance by failure of a precedent condition. If that condition is an act, the performance of which has been promised by the other party, there may also arise a claim for damages for breach of such promise.

The requirement of exact performance of conditions is modified to some extent by the doctrine of substantial performance, to be discussed later in this chapter.

3. *Conditions implied in fact.*—Conditions may not only be express—they may be implied from the attendant circumstances of a contract, and such conditions have the same effect as those which are expressly embodied in the agreement. The implied conditions are enforced because the parties must have intended them, although they have not so expressed themselves in words. To illustrate: The A Company agreed to sell to X Company certain machinery for paper-making, and to disclose and teach to the X Company secret patented processes for manufacturing paper with those machines. The purchaser agreed to pay equal annual installments of $4,000, payment to be made in paper manufactured according to the secret process. The X Company was sued later for non-payment,

and defended on the ground that the secret process had never been disclosed and taught to its staff. It was held to be an implied-in-fact condition of the X Company's promise to pay in paper manufactured by the process, that the process be first disclosed to it. It will be noted that the X Company's promise was not in terms conditional, but absolute. But, from the facts of the case, it seems clear that the parties must have understood it to be conditioned upon the disclosure.

4. *Conditions implied in law.*—Another class of conditions upon which performance may depend consists of conditions which the law implies, without regard to the express or apparent intent of the parties. These conditions may resemble conditions implied in fact, as the rules relating to them are based on obvious principles of justice. But the point to be kept in mind is that conditions of this sort are read into the contract and do not rest upon actual intent of the parties.

As an example of conditions of this sort we may take the case of the sale of an automobile to be delivered on a given day. The time for payment is not mentioned. In the absence of any proof of custom or usage to the contrary, the law infers that payment of the price is to be made concurrently with the delivery of the goods sold. Accordingly, if the buyer is not ready with the purchase price at the time the goods are tendered, he cannot maintain an action against the seller who refuses to deliver on the contract day un-

less he is then paid. The reverse holds true. Liability to pay the price of goods is presumed to be conditioned upon their concurrent delivery.

5. *Substantial performance.*—Although the general rule is that a party to a contract must perform according to the terms of his promise, the law relaxes the letter of the rule if he has performed his undertaking substantially and in good faith. Certain exceptions will hereafter be noted. If a building is constructed, for example, with a faulty door, but otherwise is according to contract, it would be unjust to hold that the contractor could not recover on the contract because he had not exactly performed. When there is a partial performance, the question is whether the failure to perform exactly goes to the root of the contract—whether it affects the contract in substance. If it does, the party at fault has no right to recover from the other. But, if it is a minor breach which does not materially affect the purposes of the contract, the ends of justice will be satisfied by allowing the injured party to deduct his damages and then to go through with the bargain.

The same considerations apply to delays in performance. Unimportant, or minor, delays by the party who is to perform first will not, ordinarily, be a material breach, but a delay beyond a reasonable time will relieve the other party from performance. Finally, the doctrine of substantial performance does not apply to any case where the breach is occasioned by bad faith or willful neglect.

6. *Time of performance.*—If it appears from the contract that performance by one party must necessarily precede that of the other, it is clear that such performance is a condition precedent to the latter's liability. When the order of performance is not indicated, the party who claims a breach must show that he is not in default. Thus, two persons may enter into a contract whereby one agrees to refrain from competition with the other in consideration of a money payment at a later specified date. After the time of payment has arrived, the party agreeing to refrain from competition may sue for its payment, but he cannot recover unless he shows that he has complied with his undertaking and has actually not engaged in competition.

When the order of performance is not indicated and no date is fixed, or a date is fixed for performance on both sides, or when performance is fixed to take place "on or before" a certain day, it is presumed that both performances are to be made simultaneously, if they are capable of being performed at the same time. Consequently, if there is no tender and no refusal to perform, neither party can be held for breach, because neither is in default.

With regard to money payments, if the contract fixes no time for performance, a tender must be made within a reasonable time. A contract may be so drawn, however, as to require performance on a fixed date, and make time of the essence. When this is so, tender must be made on the date named.

The question of time being of the essence requires some further notice. Time may be made of the essence by an express provision of the contract, or it may be implied to be of the essence from the nature of the transaction. The latter is the case if the time of performance appears to be of primary importance. On the other hand, if it appears that justice will be done all around merely by allowing a deduction of damages for the delay, time is not of the essence. In building contracts and contracts for services, time is not usually of the essence, although it may be made so by express stipulation of the parties. Time is usually regarded as very important in commercial transactions involving the carriage, shipment, and delivery of goods.

The question of time as of the essence is further discussed under particular classes of contracts in later sections of this chapter.

7. *Waiver of performance of conditions.*—The distinction between promises and conditions is to be seen in the application of the doctrine of waiver. The obligation of a promise cannot be waived so as to discharge the contract, for the waiver, without consideration, is void. But one who has made his performance conditioned on some event, or upon some performance by the other party, may waive the condition which is thus set up for his benefit. When A says that B need not perform a condition precedent, if A fails to perform his part of the contract he cannot set up B's non-performance of the condition as a defense, be-

cause this would be fraud upon B. If, for example, work is to be done within a certain time by B and A gives him a longer time, B would be justified in relying upon A's statement and acting accordingly. A waiver may be withdrawn, however, if the withdrawal is made while there is still ample time for the other party to perform.

When a condition is broken, the party for whose benefit the condition exists has the choice of two courses of action. He may choose to treat the contract as rescinded because of the breach, or he may elect to treat the contract as subsisting despite the breach. Thus, if payment is conditioned upon the delivery of goods upon a certain date and the buyer accepts a late delivery without protest, he is presumed to have waived the breach and remains responsible for performing his own part of the contract. Since the condition existed for his protection, performance may be waived by the promisor, and this he frequently does when he finds it more advantageous to continue with the contract than to treat it as ended. He cannot blow hot and cold at the same time, however, by taking the position that the contract continues for his benefit, while contending that he is not bound because of the promisee's breach of condition.

8. *Performance prevented by promisor.*—Upon the same principle, a party to a contract, who, by his own act, prevents the other from performing a condition, cannot set up the failure of performance or a breach by the other as an excuse for non-perform-

ance by himself. Thus, a buyer of goods, with payment conditioned upon delivery by a certain date, cannot set up failure to deliver if he himself refuses to take delivery.

Before this principle applies, however, it must appear that the one who was to perform the condition was ready, able, and willing to perform. If it appears that he could not, or would not, perform, whether the promisor prevented performance or not, he cannot recover on the promise. The usual case of this kind is a condition calling for the payment of money. If A's payment of money is a condition precedent to B's obligation under a contract, and B refuses to perform, A may hold him liable without paying or offering to pay. But it must appear that he was ready, able, and willing to pay.

Where one party states in advance that he will not perform either a condition or a promise, or makes his intention not to do so apparent by his conduct, the other party may treat this conduct as putting an end to the contract and relieving him from performance. The injured party, of course, may sue for breach after the time of performance and, in the case of personal service contracts and contracts for the sale of goods, he may begin his action without waiting for the date of performance.

9. *Failure to perform.*—When one party to a contract cannot perform, through no fault of his own, the other party is released from liability for his performance. It would be manifestly unjust to compel him

to go through with his side of the transaction. Illness of an employee, for instance, frees the employer from liability to pay wages, because he has not received the employee's services.

Although it is clear that one who is himself unable to perform cannot hold the other party to the contract liable, it does not always follow that he, himself, is free from liability. The questions arising out of impossibility of performance are considered in detail in a later section of this chapter.

10. *Particular classes of contracts: sales.*—The general rules relating to performance of sales contracts are, on the whole, the same as in other classes of contracts. Warranties are not in themselves conditions, but, under certain circumstances, may be treated as such. This matter will be fully considered in the chapter on "Sales—Performance—Rights and Liabilities of Parties." It may be noted here, however, that in executory contracts to sell personal property, except in cases when delivery is to be made in installments, time is of the essence. By this is meant that if the passing of title and delivery is conditioned to be made on a certain day, the doctrine of substantial performance does not apply. There must be an exact performance or the buyer will be permitted to reject the goods. Hence, if passing of the ownership and delivery of the goods is agreed to be made on January 2, a tender on January 3 will not be sufficient.

A different rule arises, however, when title, that

is, ownership of the goods, has passed to the buyer but delivery is to be made at a later date. Here a delay in the delivery will not release the buyer from his obligation to pay. He is already the owner of the goods. The same rule generally applies to cases when delivery is to be made in installments which are to be paid for separately. The question in these cases is whether the breach of contract by failure to deliver, or delay of delivery, is so material as to justify a rescission of the contract and suit for damages, or whether breach involves such slight consequences that the buyer must perform with an adjustment in price to cover any damages caused by the delay.

In many cases of sales, title passes to the buyer upon the seller's delivery of the goods to the railroad, or other carrier, for shipment, but the parties have agreed that the price is not to be paid until the goods are received by the buyer. If the goods are lost in transit, the question arises as to whether the arrival was a condition precedent to the buyer's liability to pay. The general rule in such cases is that the stipulation was intended merely to fix the *time* of payment, and was not a condition. Since it was intended that ownership should pass on delivery to the carrier, the buyer assumes the risk of loss from that time forward. This rule will yield, however, to evidence of a contrary intention.

In cases where a sale is made of specific goods which, at the time, but without knowledge of the parties, have been destroyed, or so deteriorated in qual-

ity as to be substantially changed in character, both parties are released from their contract. The law implies that the undertaking is conditioned upon the continued existence of the goods.

11. *Contracts to the satisfaction of a person.*—Not infrequently, a person contracts for services which are to be performed to his satisfaction. If the object of the contract is to gratify personal taste, serve personal convenience, or satisfy some individual preference, it is everywhere held that there can be no recovery by the one who renders the services if the other is honestly dissatisfied. His satisfaction was made an express condition precedent to his liability. A contract to paint a portrait, to design fabrics, or to make a suit of clothing illustrates such a case.

If the contract does not involve personal taste, or serve personal convenience, there is some diversity of opinion among the courts as to whether a stipulation —that what is contracted to be done is to be done to the satisfaction of the promisor—is an absolute condition to the promisor's liability, or whether he should be liable if, as a reasonable man, he ought to have been satisfied with the performance rendered. If the services involve work of a mechanical or a manual nature, such as installing ventilating machinery, or repairing boilers, the better view seems to be that the promisor must have reasonable grounds for dissatisfaction in order to avoid liability.

12. *Service contracts.*—Questions arising out of breaches of employment contracts may be considered

under two heads. First are questions arising when the breach occurs at the beginning of the contract and, second, when the breach occurs after performance has begun. With regard to the first class, it may be said that a willful breach at the beginning gives either party the right to regard the contract as terminated. Thus, if a party is hired to commence work on a certain day, and deliberately fails to report, the employer may treat the intended relationship as at an end. When illness, or some cause outside the control of a party, occasions the breach, the question of whether the contract may be treated as broken depends upon whether or not the breach goes to the essence of the contract. For instance, if illness occurs, but causes only a short delay in entering upon the employment, the employer cannot repudiate the contract, but if wages or salary have begun to be earned, he may deduct reasonable damages for the delay. It would be otherwise if the illness were for a long period of time, or likely to continue for a considerable time.

After performance of a service contract has begun, the rendition of the services is always implied to be a condition precedent to collection of payment. Impossibility of performance, however, arising from continued illness or death releases both parties, or their estates, from liability, because the law implies a condition that the parties who contract rely upon the continued health and existence of each other.

When a contract of employment is broken in some

material respects by the employee, so as to give the employer a right to discharge him, if the employer knows of the breach but nevertheless does not end the employment, he is considered to have waived his right to rescind, unless the contract expressly provides to the contrary.

13. *Severable or divisible contracts.*—A contract is said to be severable, or divisible, when several distinct items of property are to be sold, or separate or distinct services are to be rendered, and the payment is apportioned to each article or service. A contract to supply 1,200 tons of coal at so much per ton, to be delivered and paid for at the rate of 100 tons a month, or an employment contract for a year, payable at a rate of $100 a month, are illustrations. The feature of such contracts is that, on performance of one of the specified parts of the contract, the amount agreed to be paid for that part at once becomes due and payable, irrespective of whether either party, or both parties, are subsequently in default on later installments or performances. A material breach as to any installment not only bars a recovery against the other party, but it gives the other party the right, unless the breach is waived, to terminate the contract as to other installments.

14. *Discharge of contracts.*—The usual and expected method of discharging a contract is by performance, according to its terms. If all the conditions have been fulfilled and the promises on both sides have been carried out, the contract is ended.

Methods of discharge other than by performance will now be discussed, i.e., release, rescission, accord and satisfaction, novation, cancellation, merger and impossibility of performance. Most of these methods of putting an end to a contract are by different voluntary acts by one party or both parties. Impossibility of performance, in some cases, discharges the obligation by operation of law.

15. *Release.*—A release is a surrender by one to whom performance is due of his right to require that performance, or of his right of action arising from breach. A formal release may be effected by the delivery of an instrument, in writing, under seal. Such a release is not a *promise* to do something in the future. It is a present discharge and ends the contract. A gratuitous discharge by parol word of mouth of contract liability was not effective at common law. Consideration was required. The rules of the common law as to the effect of the seal have been materially changed by statute. The statutes are not uniform. In states that have *not* abolished seals, no consideration is required to support a release if it is sealed. In states which have abolished seals, or in which a seal, by statute, is made simply presumptive evidence of consideration, consideration is necessary to support the release, although sealed. In New York, the statute giving a seal merely the effect of raising a rebuttable presumption of consideration applies only to executory contracts, and, since a release is not executory, a release under seal, though

without consideration, discharges the contract as at common law.

A covenant, that is to say, a promise under seal to refrain perpetually from suing, effects a bar to an action against the obligor with whom the contract was made. A release of a right to arise in the future can only be given effect as a covenant perpetually to refrain from suit. The covenant does not discharge the obligation.

The distinction between such a covenant and a release is important where joint obligations are involved. A release of one of several joint obligors will discharge all the others, as well, unless the right to hold the others is expressly reserved. A covenant not to sue one of several joint obligors does not have the consequences of release and does not discharge the other obligors.

16. *Rescission.*—Rescission of a contract is an agreement between the parties that it shall no longer bind them. Like other contractual agreements, it must have consideration to support it. If the contract to be rescinded is a bilateral one, not fully performed on either side, the promise of A to discharge B is consideration for B's promise to discharge A and *vice versa.*

No formal words of agreement are necessary to accomplish a rescission. Such an agreement is often to be implied from facts showing that the parties have mutually abandoned the contract. Frequently this is the case where the parties enter into a new contract

relating to the same subject matter. It is then sufficient evidence that they choose to rescind the old one. Such new contract, it should be noted, will not amount to a discharge of the old one, unless *each* party under the new contract binds himself to do something different from that which he was already bound to do. Otherwise, there would be no consideration for the new promise, because agreeing to do, or doing, what one is already bound to do under an existing contract is no consideration.

A unilateral contract, or a bilateral contract, which has been executed on one side by performance, cannot be discharged as to the outstanding obligation by a mere mutual agreement without consideration. Thus, if A has performed, but states under seal that he waives his claim against B, this statement does not discharge B, even though acquiesced in by B. To make effective A's promise to discharge B, B must give some consideration.

Requirements of the Statute of Frauds may necessitate the discharge of a contract that is in writing to be in writing likewise. Unless this is the case, a discharge may be oral and the contract to discharge a contract under seal may also be by word of mouth, or by simple written contract.

17. *Accord and satisfaction.*—An accord is an agreement by one party to give, and by the other party to receive, something of value in satisfaction of an existing right of action. Performance of the accord is a satisfaction. An accord, alone, is not

enough to discharge the prior obligation; the performance of the agreement, that is, the payment by the one, and acceptance by the other, of the thing agreed upon, is what gives it effectiveness as a discharge.

The requisites of a satisfaction are the same as those of consideration. The adequacy or inadequacy of the satisfaction is immaterial, but payment of part of an undisputed debt is not a good satisfaction, nor the giving of any other thing, or act, that would be insufficient as consideration for a promise. The tests of a valid satisfaction and of valid consideration for promises generally are the same.

A check marked in full satisfaction of a disputed claim, or a statement to the same effect, sent with a check, followed up by a reply from the creditor that he will apply the check on account, but will not accept it in full payment, is generally held to be a good accord and satisfaction because the creditor cannot keep the check without accepting the terms on which it is sent to him. A few jurisdictions, however (see Chapter III, Section 17), hold to the contrary.

18. *Account stated.*—An account stated is a statement of account between the parties fixing a definite sum as the amount due, on a prior debt, or debts, which the debtor expressly, or impliedly, agrees to pay. The new promise takes the place of the old obligation and discharges the debt, or debts, from which the account is derived. The creditor's action

is brought on the account stated, and the items of indebtedness need not be set forth, or proved, in the action. There need be no consideration, other than the prior indebtedness, for the promise to pay the account stated.

The more usual form of an account stated is where the creditor submits a statement of account which is retained for an unreasonable time by the debtor without objection.

19. *Novation.*—When there is a novation, a new contract is made and substituted for the old. It is necessary that all parties to the old contract, as well as the new obligor, be parties to the new contract.

20. *Cancellation.*—Contracts under seal and negotiable instruments are more than written evidence of contracts; they are the actual contracts, and their surrender and cancellation results in their discharge. In the case of negotiable paper, surrender alone before maturity, with intent to discharge, will effect a good discharge as between the parties. It will not, however, be effective against an innocent purchaser for value if the instrument is wrongfully transferred to him before maturity by one who has apparent title as payee or indorsee.

Surrender of a written contract that is not a negotiable instrument, or under seal, is only evidence of a discharge, and whether or not a valid contract of discharge has actually taken place will depend on the principles previously discussed in this chapter.

21. *Merger.*—When a judgment is recovered on

a contract obligation, the contract is merged in the judgment, which replaces it. Likewise, when a contract under seal is made, replacing an existing contract between the same parties not under seal, the latter is discharged by merger in the sealed agreement. The same result follows the giving of a negotiable instrument (bill or note) in discharge of his debt by a debtor to the creditor, if this is the intention of the parties. If it does not appear to be their intent, however, it is considered merely a means of payment rather than a payment, and the debt is not discharged. Unless it is apparent that the bill or note is intended to be given and accepted in discharge of the prior debt, action may be brought upon the original claim if the instrument is dishonored.

22. *Impossibility of performance.*—Although there is a widely held lay opinion that impossibility of performance discharges a contract, the courts recognize only limited classes of cases in which this is true. Indeed, the general rule is that impossibility of performance is no defense to liability for breach of contract. Impossibility of performance should be distinguished at the outset from unexpected difficulty of performance. The mere fact that a contract turns out to be difficult to perform is not an excuse for non-performance. A contractor, for example, assumes the risk of increased prices in materials and in the demands of labor.

It has been said that "when the party by his own contract creates a duty or charge upon himself, he

is bound to make it good, notwithstanding any accident by inevitable necessity, because he might have provided against it by his contract." In other words, to be safe, the promisor should make performance of his obligation conditional upon continued ability of performance.

The general rule is somewhat harsh and there are some exceptions to it. These will now be considered.

23. *Change in law.*—When, by change in the law, the act contracted to be done has become illegal, the promisor is relieved of his contract. The reason for this is that a party cannot be required to break the law.

24. *Personal service contracts.*—The death, or continued illness, of an employee who has contracted to render personal services will terminate the contract. The illness of the employee must continue beyond a reasonable time before the employer may terminate the contract on that ground. Likewise, death or illness of the employer will discharge the contract, if his relation with the employee is a personal one. But this is not generally held to be so when the situation is such that supervision over the employee was, or could be, delegated to a superintendent or foreman. In many cases of employment contracts, the employer's contract is not personal in its performance, although the employee's always is.

25. *Destruction of the subject matter.*—A contract to sell identified goods necessarily involves their continued existence. Their destruction, therefore, ends

the contract. If only a part of the goods is destroyed, or seriously damaged, the buyer may elect either to rescind, or to take what is left and pay for them pro rata if the contract was divisible. Otherwise, he must pay the full price. For the same reason, destruction of a building, or ship, or other thing essential to the performance of the contract, discharges it. Thus, the burning of a cheese factory was held as sufficient cause to discharge the owner from his contract to manufacture cheese from milk supplied by farmers in the neighborhood. On the other hand, a contract of employment to sell the employer's products manufactured in his factory was not discharged by the burning of the factory.

The usual way of explaining the different cases of impossibility of performance arising after the contract is made is that a condition is implied in fact, based on the reasonably presumed intent of the parties, that the person, or thing, essential to performance will continue to exist so that performance can be made. The use of the factory, ship, or other means of performance must have been clearly understood as the sole means of performance in order that a condition of this kind will be implied. A sale of goods not identified, or a contract to manufacture goods, without specifying the means of manufacture, will not be discharged because the contractor's goods or the factory with which he intended to fulfill the contract, have been destroyed. In the case of a building contract, destruction of the building by fire, tempest,

or otherwise, before completion, without the fault of the builder, does not discharge him from his contract or extend his time for performance.

It is often said that "acts of God" excuse performance. This is not a reliable rule upon which to depend. It is not always possible to determine what is an "act of God." The destruction of a building, in course of construction, by a tempest might be said to be an "act of God," but it would not discharge the contractor.

REVIEW

Define these terms—an absolute promise; an express condition precedent; a condition implied in fact; a condition implied in law—and give an example of each.

What is meant by the doctrine of substantial performance.

Define waiver and outline its effect when made after a breach of condition.

If a promise is made to perform to the satisfaction of another, what two general rules apply?

Explain the features of a divisible contract and distinguish it from an entire one.

Name the several ways in which a contract may be discharged.

What is the requisite of a satisfaction?

Explain "novation."

Under what circumstances are contracts discharged by impossibility of performance.

CHAPTER VI

AGENCY—CREATION AND TERMINATION

1. *Nature of agency.*—In legal and commercial usage, an agent is a representative employed to act for another—called the principal—in negotiating and making contracts and other commercial relations. A servant, while likewise a representative, is one who performs for his master acts of service not resulting in contracts. The representative may be both agent and servant in the same transaction, as in the case of a traveling salesman using his principal's car in going about taking orders. In running the car he is his principal's servant, and the principal's liability for his negligent operation of the car will be determined according to that branch of the law classified as the law of master and servant. In negotiating sales and taking orders, the representative acts in the capacity of agent.

This chapter and that immediately following will be concerned chiefly with the law of agency.

2. *Competency of the parties.*—We have seen in an earlier chapter that certain persons, as, for instance, infants, are subject to limitations on their capacity to contract. These limitations as to capacity apply equally whether such persons contract

directly or through an agent. Thus, if an infant employs an agent, the contract of agency itself may be avoided by the infant and the infant may likewise avoid any contract made by the agent in his behalf.

Infants, and other classes of persons who are subject to limitations in their capacity to contract, however, may act as agents, and contracts, made by them on behalf of the principal within the scope of the agency, are binding upon the principal. Thus, if a competent adult person constitutes a minor as his agent to negotiate a contract, the contract will not be affected by the fact of the agent's minority.

3. *Unincorporated associations as principals.*—Unincorporated clubs, political parties, college classes and the like are not legal persons. The club, party, or class, as such, cannot be a principal. The members of such a body, however, by their joint act may appoint an agent to act for all of them, and in such a case the members will be bound as principals by what the agent does within the scope of his authority. The question here is: Did the members intend to become bound jointly so that each intended to pledge his personal credit, or did they intend that payment should be made only out of the joint funds of the association? Usually the latter will be found to be the case.

When the joint enterprise is directly or indirectly for the individual, financial benefit of the members, they will be held liable. The same result follows where the constitution and by-laws of the association provide that they shall be individually bound.

4. *Joint agents.*—Sometimes two or more persons are appointed by the principal to act together as agents. In such a case they must so act, as the principal has a right to rely on the combined discretion and judgment of all of them.

A partnership acts through any one of its members and the act of one partner is the act of the firm, provided it is within the scope of the partnership business. Therefore, if a partnership is appointed as an agent, the performance of the agency may be by the act of any one of the partners.

A corporation is a legal person. It acts through its board of directors by majority vote, and through its executive officers under the direction of the directors. In most instances of transactions by a corporate agent, however, the agency may be performed by an executive officer without action by the directors.

5. *Creation of agency by express appointment.*—The relation of principal and agent usually arises by express appointment of the agent by the principal, and the appointment, as a rule, takes the form of a contract. But an enforceable contract is not necessary between the principal and the agent in order to give validity to the agent's appointment. If one person gives express authority to another to act in his behalf, the relation of principal and agent arises between the parties, though the agent is to act gratuitously.

Whether or not a person has been given authority to act as agent for another is a question of fact to

be determined from the words and conduct of the parties and the circumstances of the case. Where the agent's work is intended to be gratuitous, there is no contract between the parties because of the lack of consideration; but contracts made with third persons by such an agent on behalf of his principal are nevertheless valid and enforceable as between the third person and the principal.

Written authorization of an agent to act as such is not generally necessary, even though it is contemplated that he is to make written contracts on behalf of the principal. As a rule, therefore, an oral authority to execute a written contract will be good, although the contract is one which must be in writing under the Statute of Frauds. In a few states, statutes provide that written authority is required where the agency involves the making of written contracts. In New York, though a deed conveying land is not required to be under seal, an agent's authority to execute the deed must be in writing.

At common law, authority to execute an instrument under seal has to be under seal. The necessity of seals in most states has been abolished, but seals still are attached often to instruments to which they are not essential. The chance affixing of a seal to such an instrument will not invalidate an oral authority given to the agent to execute it. In some jurisdictions, however, certain instruments, principally deeds conveying real estate, continue to be required to be under seal. If such is the case, the authority to ex-

ecute the instrument under seal must be in writing also under seal.

6. *Creation of agency by ratification.*—One of the most important matters in the law of agency is that of ratification by a person of unauthorized acts done on his behalf by another. It is obvious that, as a general rule, if one person without any authority to do so purports to make a contract on behalf of another, or makes a contract outside the scope of his authority, such unauthorized action cannot bind the person for whom he professes to act. The person who has been represented to be the principal may, however, ratify such an unauthorized act, thus making it as binding upon himself as though express authority had been given. This is a doctrine peculiar to agency.

Most of the law of agency is simply the law of contract applied to cases involving the principle of representation, but this doctrine of ratification cannot be explained upon principles of contract. If it is argued that the unauthorized transaction is an offer to the principal accepted by him when ratification occurs, the theory of contract fails in those cases in which the third person's performance has been completed before ratification, for then the consideration for the principal's promise would be past. Yet ratification is just as valid in such a case as it is where the promise of the third person is still to be performed when the ratification occurs. All that can be said, then, is that the doctrine of ratification is peculiar to

the law of agency and has no direct relation to the principles of contract.

7. *Requisites of ratification.*—Before there may be an effective ratification in the first place, there must have been a principal in existence when the unauthorized contract was made, who was capable of authorizing the contract. A contract made in behalf of a corporation not yet organized cannot be ratified by the corporation after it comes into existence. The corporation may "adopt" such a contract after it is organized. This so-called adoption is really nothing more than accepting an offer which continues by its terms until acted upon by the corporation. The contract arises when the offer is accepted by the corporation and does not relate back, as it would in the case of ratification.

A second requisite is that the agent, when dealing with the third party, must either affirmatively state that he is acting for another as principal, or the facts must be such as to show that he purported to act in that capacity. Thus, if A makes a contract in his own name, but really intending it to be made on behalf of a principal whose name he does not mention and whose identity is not disclosed, the undisclosed principal cannot ratify the contract because the third party never intended to make a contract with him. But where a son makes contracts in his own name to have extensive repairs and improvements made on his mother's property, it is quite apparent to the third person, from the facts, that the son intended to

act for his mother, and hence a ratification by her would be good.

The third essential is that the principal, to be bound by a ratification, must have knowledge of all material facts connected with the transaction of the agent when he ratifies.

8. *Ratification by conduct.*—Subject to the above requisites, the ratification of unauthorized contracts made by an agent may be by express words, or by conduct. The supposed principal is not bound to ratify, of course, but, when he does, the contract becomes his and he is bound by it.

Express ratification by words needs no elaboration, because it is sufficiently clear from the words that the principal ratifies and adopts the contract. Ratification by conduct presents some difficulties. These difficulties usually arise, however, when the supposed principal, with knowledge of the agent's transaction, accepts benefits under the contract. Any conduct showing an intent to ratify will be enough. Ignorance of a material fact, on the other hand, if proved, will defeat ratification. A person cannot ratify that of which he is ignorant.

To illustrate: In one case a principal had given an agent authority to sell certain bonds for $5,000, and the agent, in excess of his authority, guaranteed the soundness of the bonds as an investment in order to induce a sale. The fact that the principal received the proceeds of the sale of the bonds was held not to bind him to the guarantee, because he had no

knowledge of the agent's statement. Had the principal received the purchase money with knowledge of the guarantee, the result would have been otherwise.

9. *Form of ratification.*—Ratification must be in writing and under seal only in those cases in which a written or sealed authorization would have been necessary if the act had been authorized. We have seen that a seal is necessary only in cases where a sealed instrument is to be executed, and that the use of a seal where it was not necessary, and not required by the principal, does not invalidate the parol, or verbal authority which otherwise would be good. Written authority or ratification is not necessary in the case of contracts in writing not under seal, though statutes in some states require written authority to execute deeds and leases that have to be in writing, though not under seal.

10. *Right to withdraw before ratification.*—Before ratification, neither the principal nor the third party is in any way bound, and therefore the third party may withdraw, or cancel, the so-called contract before ratification has taken place.

11. *Effects of ratification.*—The contract becomes, through ratification, as effective and valid in all respects as if it had been originally authorized, not only as to principal and third party, but also as to principal and agent. The relating back of the ratification is actually a fiction which the law finds convenient so that justice may be done, and this fiction is recog-

nized as such where its operation would result in obvious injustice. Therefore, where the law requires the giving of a notice at a stated time, as for instance a notice to quit, or of dishonor, a notice, invalid because unauthorized, is not validated by ratification so as to take effect as of the original date. It will be a good notice only as of the date of the ratification duly communicated, which would be the first valid notice.

The rights of third parties, likewise, such as attaching creditors, arising after the unauthorized act and before ratification, will not be defeated by such ratification. The fiction will be applied as between the parties but not so as to destroy a right that a stranger to the transaction acquired before ratification. The purchase, or other unauthorized act of the agent, was really void, and a subsequent attachment or execution upon the goods before ratification gives the stranger an actual lien which cannot be affected by the legal fiction of relating back.

12. *Agency arising by estoppel.*—A man who makes a false statement of a material fact to another, by which the second, acting as a reasonable man, is misled, is estopped from denying his false statement, if asserting the actual truth would result in damage to the person misled by the false statement. A simple illustration of this principle is afforded when Smith tells Jones that he has sold his horse to Robinson, and that it can be bought from Robinson at a bargain. Jones buys the horse from Robinson. The fact is that Smith had merely loaned the horse to

Robinson for a week. In an action by Smith against Jones to recover the horse, Smith would be estopped from denying his false statement that he had sold the horse to Robinson. Jones, therefore, would have title to the horse by estoppel because Smith would be estopped from setting up his real title and ownership.

This principle applies to agency in any case where a man falsely holds out another person as his agent to a third person, who then deals with the alleged agent in the belief that the representation is true. An agency arises by estoppel because the principal will be estopped from denying his false statement, or misleading conduct, and he will be held liable for the acts and contracts of the agent with such third person, exactly as though the agency had existed as he said it did.

The misrepresentation may be, and usually is, made by conduct rather than by express words. When a man has permitted another to act for him in a series of transactions, without dissent, though admittedly he has never given him authority, or although authority has been revoked without notice to the third person, an agency by estoppel arises as to the person with whom such transactions occurred. Thus, in a case where a clerk, to the knowledge of his employer, was permitted to cash small checks to get money to be used for petty cash, without objection, though admittedly he had not been authorized to indorse checks, the principal was estopped from denying his authority to the bank. The bank had a right to rely upon

the apparent authority given to the clerk by this series of transactions, though the clerk subsequently cashed such checks and stole the money.

13. *Termination of relation of principal and agent.* —The relation of principal and agent ends upon the arriving of the date, or the happening of the event, on which it was to end according to the contract or appointment creating the agency. It may be ended, of course, by mutual agreement. It may also be ended at any time by either party without the consent and against the will of the other, though such termination constitutes a breach of contract, if a valid contract existed to continue the agency for a fixed period.

14. *What constitutes revocation.*—No form of express revocation is necessary. A power of attorney under seal may be revoked by parol, that is, verbally. All that is necessary is that the principal notify the agent that his power to represent him is ended. Revocation may also be implied from circumstances showing that the principal intended to revoke. This revocation necessarily will be true when he disposes of the subject-matter, or loses control of it; it is true, also, if it is destroyed by fire, or if the subject-matter is an animal and it dies.

Appointment of another agent to do the same act revokes the authority of the first, when the act is one for the performance of which only one of them may be employed. In most cases, however, several agents may be employed to accomplish the desired result, so that the appointment of another agent will

not revoke an existing agency, as in the sale of a house, or the collection of a debt. Though only one may succeed, several may be employed to try.

15. *Notice of revocation.*—Notice of the revocation to the agent is obviously necessary, as is notice, to the principal, of renunciation by the agent. Notice to third persons is required only for the purpose of preventing an estoppel in case of a continuing agency which involves a succession of transactions with the same persons, who would have a right to believe that the agency still continued, unless notice of revocation were given to them.

16. *Revocation by operation of law.*—The general law of contracts, as treated in earlier chapters, deals with the termination of contracts through operation of law, and these rules apply equally to the contract of agency. Like other contracts, that of agency will be ended by a change in the law which makes performance illegal, and therefore impossible. This condition is illustrated by a contract of employment with an insurance company to sell insurance which is subsequently made illegal, and therefore impossible, by the taking away of the charter and the forced dissolution of the company.

17. *Death of either party terminates the agency.*—A dead man cannot act through an agent, and, therefore, the death of a principal necessarily terminates any existing agency. The agent's death also necessarily brings his contract to an end. Survival of the power after the principal's death, where the power is

coupled with an interest in the subject matter, will be discussed hereafter. Bankruptcy also terminates any agency relative to the principal's property or contracts, since everything of that nature passes to the assignee in bankruptcy.

18. *Irrevocable agencies.*—A power coupled with an interest in the subject-matter cannot be revoked, except by mutual consent, during the principal's life, nor is it revoked by his death. The usual case is where the property involved is transferred to the agent to secure a debt due him, with power to sell, and pay to himself the debt out of the proceeds. Here the power to sell runs with his title to the property, and is necessary to give effect to the security. As the title is in himself, the difficulty of transferring the title of a dead man, as his representative, is obviated.

The later cases recognize the fact that exactly the same principle applies when an equitable interest in the subject matter has been transferred by way of security, though the legal title has not passed. Therefore, in the case of an agent to collect rents, with power to apply the rents to the payment of a loan, the loan having been made as part of the contract, the agency and power were held to survive the death of the principal for whom the rents were collected. Though the rents had not been assigned, nevertheless, in equity, they were regarded as mortgaged to secure the debt, and the power to collect them was of the essence of the security.

In these cases, no security of the nature of an

equitable mortgage arises, unless the debt that it secures was incurred in reliance upon the security. When a legal mortgage, or pledge, exists, this element of consideration is not necessary. The transfer of the legal title, or interest, by way of security for a past debt, is sufficient. If no title or interest is conveyed at law, however, the mere interest of the agent in the proceeds of the sale is not enough. His agency is revoked by the principal's death.

A power coupled with an obligation is also irrevocable. In these cases, the agent has assumed an obligation to a third person relying on his agency. The injustice of cancelling the power by which the agent may protect himself is apparent. Therefore, death of the principal does not take away the agent's power where he has incurred liability to a third person in the discharge of his contract as agent, and, of course, the power cannot be revoked by the principal during his life. Thus, where the agent promised to pay a sum of money to a third person at the order of the principal, from funds of the principal in the agent's hands, the principal could not thereafter revoke his authority to apply the funds to the payment as ordered.

REVIEW

Distinguish an "agent" from a "servant."

Outline the requisites of ratification.

Explain how agency may arise from estoppel.

How may an agency be terminated?

What is the importance of notification to third persons of the termination of an agency?

What agencies are held irrevocable?

CHAPTER VII

PRINCIPAL, AGENT, AND THIRD PERSONS

1. *Obligations of principal to agent.*—The agent's right of compensation is determined by the terms of the contract. If the services are rendered on request, a promise is implied, from such request, to pay their reasonable value. If, however, it appears affirmatively that the services are intended to be gratuitous, no such promise will be inferred. This is the case when services obviously intended to be gratuitous are rendered between father and son, or other immediate members of the same family.

Even without a request, the knowing acceptance of services, when there is no good reason to regard them as tendered gratuitously, gives rise to the implication of a promise to pay their reasonable value.

2. *Effect of revocation of agency on compensation.* —As was stated in the previous chapter, an agency may be terminated by the principal without the consent of the agent, though by the terms of the contract of agency it was to continue for a fiscal period, and contracts made by the agent do not bind the principal.

However, such termination of the agency contract before the term of the agency expires constitutes a breach of the contract and, if it is unjustified, en-

titles the agent to sue the principal for damages. Thus, if an agent has been employed for a year and is discharged without cause, he may sue for breach of contract and recover the entire damages sustained by him, prospective as well as present. That is, he may recover the salary or wages due at the time of discharge and damages for the unjustified discharge. The damages will be the amount of salary that would have been earned under the contract, less what he has earned or could earn by reasonable diligence in new employment of the same general character.

If the agent breaks the contract and the contract is divisible, as in cases where the agent is employed on a yearly contract but each week's or month's service is measured by a weekly or monthly compensation, the agent may recover salary already earned, less damages resulting to the principal from the agent's breach.

When the agency is not for a definite period, it may be ended, of course, by either principal or agent at any time, without liability for damages. The agent may then recover full salary for the actual period of his service at the rate fixed in the contract. It should be observed that payment of salary by the week, month, or year does not create an obligation to complete the period in such cases. For instance, nothing appearing to show a contrary intent, a contract to pay an agent $5,000 a year is not construed as a contract for a year, but as fixing compensation at the rate of $5,000 a year. The contract is an indefinite hiring

which can be terminated at will by either party. If, however, it appears that the agreement was to employ and serve for a year at a salary of $5,000, the contract would be for the definite period of a year.

When the contract of agency is ended by operation of law, or by death, insanity, illness, or other cause, without fault of either party, the full salary earned up to that time may be recovered, without deduction or addition of damages for breach of contract, because the contract is discharged, not broken. If the principal become bankrupt, though the agency is thereby ended, liability for damages exists, arising from the termination of the service. The bankruptcy, whether voluntary or involuntary, effects a breach of contract.

3. *Compensation where agent acts for both sides.*— If an agent acts for both parties to the transaction with their knowledge, he is entitled to compensation from both. If he conceals the fact that he is acting for both, his conduct is a fraud, or potential fraud, on each, and he is entitled to receive nothing from either party. Such double agency, without the consent of the parties, is inconsistent with his obligation to act with good faith toward the principal. Each principal, under these circumstances, is entitled to recover from the agent such compensation as he may have paid him. Such service under the law is worth nothing.

In addition to forfeiting all compensation in such cases, the agent is liable to each of his principals for damages. If the agency involved a sale of goods or

real property, for example, the seller may recover from the agent a sum equal to the commission which the agent was to receive from the purchaser, because the agent could have sold the property to the purchaser for that much more had he acted for the seller in good faith. The purchaser, on the other hand, for the same reason, may recover from the agent the amount of commission that the agent was to receive from the seller, because he could have purchased the property for that much less if he had been acting in good faith as agent of the purchaser.

It seems settled under the later cases, however, that where the agent, as a broker, is employed merely to bring the parties together so that they may make their own bargain without any effort on his part to get them to arrive at terms, he can recover the agreed commissions from both and, of course, he then incurs no liability for damages. This is also the case where he finds a purchaser ready to pay the price fixed by the seller, without negotiation. It is argued that, since the seller gets his price, he has nothing of which to complain. This attitude is poor morals, if not poor law. The broker is bound to get the best price he can for his principal, and, if he finds a buyer willing to pay more than the price that the seller asks, the broker should not be allowed in effect to pocket the excess in the form of a commission from the purchaser.

4. *Reimbursement and indemnity.*—The principal must reimburse the agent for all payments made, or

liabilities reasonably incurred, by the agent in the due performance of his duties. If the contract, or enterprise, in the bringing about of which the agent was employed, was illegal and the agent knew, or should have known, of the illegality, he could, of course, neither recover compensation nor have reimbursement for payments made or liabilities incurred by him.

The agent is entitled to indemnity from his principal, if he has incurred liability to a third party while acting in good faith and according to the principal's instructions. For example, a railroad conductor, instructed to reject a certain kind of ticket, who was held for damages by a passenger whom he ejected from the train pursuant to such instructions, was held entitled to indemnity from the railroad company.

So also an agent who, when so instructed by his principal, sells, or otherwise converts, goods of another in the belief that they are the principal's goods, is entitled to indemnity from the principal. If, however, the agent knows the facts, he is a willful wrongdoer and is not entitled to indemnity.

5. *Obligations of agent to principal.*—The relation of principal and agent imposes obligations upon the latter which must now be considered.

(a) OBEDIENCE.—An agent must follow his principal's instructions and is liable for damages resulting from any material departure from them. Thus, where flour was shipped to an agent to sell at once, and the agent delayed the sale for some time because of market conditions and in the hope of getting a

higher price, though he could have readily sold the flour at once at a slight concession from the market price, he was held liable for the loss arising from a considerable drop in the market price. The delay by an agent in purchasing tea in China, the agent hoping for a lower price, resulted in charging him with the loss when the price advanced, since it appeared that, had he acted with reasonable promptness, he could have purchased the tea at the price set by his principal.

(b) DUTY TO USE REASONABLE CARE AND SKILL.—An agent must use the care that would be exercised by the average man of his profession or calling. A lawyer, in acting for a client, must exercise the skill of the average lawyer; a financial man, in investing money for his client, or lending it on collateral security, must act with the knowledge of investments and exercise the skill that one has the right to expect of the average financial man dealing with such affairs. A real estate agent, in renting property to tenants, must make reasonable investigation as to the solvency of the tenants. An agent, to collect debts, must use due diligence and employ the usual means of collection. He will be liable for a failure to make presentment and demand for payment, and to give notice of dishonor as required by law in collecting negotiable bills or notes.

In special emergencies, where the agent cannot communicate with his principal in time, and the literal carrying out of his instructions is impossible, he is

permitted to do what seems best in the reasonable exercise of his discretion. Thus, an agent in charge of a cargo of merchandise to be sold at a foreign port, finding on arrival that there is no market for the commodity at that port, except at ruinous prices, may seek the nearest market and dispose of the cargo to the best advantage under the circumstances.

Although the agent impliedly warrants, when he accepts an appointment, that he possesses a reasonable degree of skill for the duty, he does not warrant that he will not make mistakes. As has been well said:

> Whoever bargains to render services for another undertakes for good faith and integrity, but he does not agree that he will commit no errors. For negligence, bad faith, or dishonesty he will be liable to his employer; but if he is guilty of none of these, the master, or employer, must submit to such incidental losses as may occur in the course of employment, because these are incident to all avocations, and no one, by an implication of law, ever undertakes to protect another against them.

(c) GOOD FAITH.—An agent is a fiduciary and is held to the highest standards of good faith in his relations with his principal. That is why, as has been noted, an agent is not permitted to act for both parties without their knowledge that he is so acting. Neither can he act for his own private gain in the performance of his duties as agent. An agent to buy cannot buy from himself. A principal, discovering that an agent has so purchased may repudiate the

transaction though the price was fair. It is for the principal alone to decide whether or not he will ratify the purchase, irrespective of whether he was injured or benefited.

An attorney, employed to examine a title, cannot acquire an adverse lien or title and enforce it against his principal. An agent, in charge of his principal's land, who should pay the taxes, or advise his principal of their non-payment, cannot buy the land at a tax sale and set up the tax title against his principal. An agent so purchasing holds the land as trustee for his principal.

As a fiduciary, the agent must keep accurate accounts, render accounts to his principal when required, and turn over to his principal all money, or other property, belonging to his principal, which comes into his hands.

6. *Delegation of authority by agent to others.*— The performance of all kinds of routine duties requiring no particular skill or discretion may be turned over by the agent to clerks or other subordinates. The service of a notice to quit upon a tenant; the service of the different papers in an action conducted by an attorney for his client; the typewriting and mailing of letters, etc.; and the drawing up and signing of documents as instructed by the agent, offer illustrations of matters that may be delegated. Lawyers, as a matter of custom, may employ other lawyers in their offices and may use them very freely under supervision in the performance of important

duties to their clients. Generally, however, matters involving the judgment and discretion of the agent cannot be delegated to a third person without the principal's consent. In all these cases, the employee of the agent acts as the representative of the agent, who is responsible to the principal for what he does. The acts of the employee of the agent are the agent's acts. The employee is not himself an agent of the principal. The principal, however, is bound by his acts as acts of the agent.

7. *Subagents.*—The agent may appoint subagents to act as agents of the principal if authority is given him so to do. No difficulty arises in the case of a general manager with authority to employ and discharge subordinates. He is, among other things, an agent to employ other agents. Difficulty arises in an agency for a particular purpose, as to collect a bill or note, or to bring a suit. When a bill or note is given to a bank for collection, the depositor understands that his bank must send the instrument to another bank if it is payable in another place some distance away. Is the correspondent bank agent of the home bank, or of the owner of the paper, in such case? The more general rule is that laid down in the New York cases to the effect that the home bank remains liable throughout to the owner of the paper, and will be liable for the negligence, or other wrong, of the correspondent bank. In many states, however, it is held that the home bank discharges its duty in exercising due care in the selection of the corre-

spondent bank, which then becomes agent of the owner to which he must look for damages arising out of its negligence.

8. *Liability of gratuitous agents.*—That gratuitous agents, that is, those who act without compensation, cannot be held liable for breach of contract goes without saying, since no contract exists because of the absence of consideration. If, however, a gratuitous agent actually has entered upon the performance of his agency, and is negligent, he is liable. It is said that such an agent is called on to exercise "slight" care, or that he is liable only for "gross" negligence. These expressions "slight" and "gross" are meaningless, except as they express the idea that payment of compensation for the service should be considered as one of the circumstances of the case in deciding whether or not reasonable care has been used.

The gratuitous agent must use the skill and knowledge that he pretends to have, either as a lawyer, financial man, real estate expert, or the like. If he has failed to exercise the skill and knowledge of the average man of his profession, or calling, in the discharge of the agency, he is guilty of negligence and liable accordingly. In a doubtful case, the gratuitous nature of the agency will be material in determining whether or not the agent was negligent, but not otherwise. Negligence is negligence, and is made neither better nor worse so far as liability is concerned by calling it "slight" or "gross."

Where the gratuitous agent has not entered upon

the service at all, neglecting or forgetting it, as, for instance, to take out insurance on a ship, he cannot be held. Since he simply has failed to do anything, he cannot be held for doing it negligently. He cannot be held in contract, as we have seen, because of the absence of consideration.

9. *Liability of principal to third persons.*—That the principal is liable for contracts, or other acts, of his agent, made or done within the actual or apparent scope of his authority, has been emphasized heretofore as a fundamental principle of agency. Difficulties arise in determining whether or not an act of the agent was within the apparent scope of his authority. He has express authority to do everything that is necessary and reasonable in accomplishing what was expressly authorized. When he has no actual authority to do a thing, the principal, nevertheless, will be bound by his acts if, expressly or impliedly, he held out the agent as having such authority. Cases illustrative of this have been discussed in the previous chapter under the subject of agency by estoppel.

The starting point of the law of the principal's liability to third parties is that the third party dealing with the agent must find out for himself what authority the agent actually has, and, if he has not been misled by a false statement, or other holding out by the principal, he can hold the principal only for such acts of the agent as come fairly within the scope of the actual authority. It will be helpful to inquire into the nature of the general scope of the agent's

authority in the more important classes of agents, for illustrations of the general principles by which the scope of an agent's authority may be determined.

10. *General managers or general agents.*—If an agent is made general manager of a business, he has actual authority to do anything, or make any contract, coming fairly within the carrying on of the business. Secret instructions by his principal will not alter this situation. Where instructions are given not to do things that come fairly within the limits of the business, though the agent has no actual authority to do them, there is a holding out of the agent as having such authority because of the nature of the business. Under such circumstances, persons dealing with the agent may hold the principal liable for such acts of the agent, unless they knew of the secret instructions.

11. *Authority of agents to sell.*—An agency to sell carries with it the power to fix the price and the terms of sale generally, and to receive payment, if the agent has possession of the goods. If the agent has not possession, he has no authority to receive payment, unless expressly authorized, unless it is the custom of the trade, or unless he has been permitted to accept payment in similar transactions with the same purchaser.

He has no authority to sell on credit, unless it is customary in the trade to sell such goods on credit, or unless he has made sales before to the same vendee on credit, ratified by the principal. He has no im-

plied authority to barter, pledge, or mortgage the goods, or to sell them at auction.

He has no authority to give a warranty of quality in the usual case. Such authority will exist when expressly given, or if it is the general custom of the trade to give warranties in sales of such goods, or when, in similar previous sales by the same agent to the same purchaser, warranties were given of which the principal knew.

12. *Authority of agents to buy.*—Factors are those employed regularly in the business of receiving goods on consignment for the purpose of sale. If a factor sells at an increased commission in consideration of his guaranteeing to the principal the collection of the price, he is known as a *del credere* factor. Factors have far greater implied powers to sell than ordinary agents. They may sell in their own names, and may fix the price, time of delivery, and other terms; they may sell for cash and receive payment, or sell on credit and take a draft or note in payment. Moreover, they may pledge the goods to secure advances made by them to the principal, but not otherwise. Purchasers without notice take good title, though the factor may have sold contrary to instructions.

Under the Factor's Acts enacted in England, New York, and in many of the other states, a purchaser or pledgee for value of such goods, believing the goods to be the property of the factor, is protected. The owner cannot reclaim the goods from such purchaser, or pledgee, except on payment of the amount ad-

vanced to the factor. Of course, the factor is liable to his principal for any sale or pledging of the goods in violation of his instructions or authority, except that he may sell, after reasonable notice, to reimburse himself for advances made on the goods for which he has a lien, though against the instructions of his principal.

13. *Brokers.*—Brokers differ from factors in that they do not have possession of the property that they sell. They cannot receive payment, therefore, except when expressly authorized, or when custom or prior usage between the same parties permits; furthermore, they cannot sell in their own names. The special reasons, therefore, for protecting pledgees or purchasers from factors do not apply to pledgees or purchasers from brokers; the general principles of agency, as heretofore discussed, apply to them.

14. *Real estate brokers' commissions.*—At this point we may conveniently take into account some other matters concerning brokers as agents. Real estate brokers must have licenses to act as such in New York, New Jersey, and many other states, and are subject to a penalty for failing to comply with the law. In such states, a broker cannot recover commissions unless he has a license.

Commissions are not earned by real estate brokers for selling real property, or securing loans, until they have produced a purchaser ready, willing, and able to buy the property on the vendor's terms, or a lender ready, willing, and able to make the loan. If a con-

tract of sale is signed, the vendor accepts the purchaser as ready, willing, and able, and the commission is earned. The broker is not deprived of his commission when the vendor refuses to make a contract after a purchaser is introduced to him who is ready, willing, and able to buy on the vendor's terms, as given to the agent. Likewise, if the vendor's title is defective, and the sale falls through on that account, the broker may recover his commission.

15. *Discharge of real estate brokers.*—Brokers working on a commission basis are not ordinarily employed by a contract of employment. Payment of commissions depends entirely on their success in finding a purchaser for the property of their principal. Generally, the broker is not bound in any way, and, therefore, the owner is equally free and may withdraw the property at any time without any payment to the agent, even for disbursements. The agent makes such expenditures, as for advertising, in the hope of securing a purchaser, and thus a commission.

When, however, the broker presents to the owner a purchaser ready, willing, and able to buy on the terms fixed by the owner, a unilateral contract arises, binding the owner to pay commissions agreed upon, as stated in the previous paragraphs of this chapter. Occasionally, the broker gives a consideration to the owner in return for the owner's promise not to withdraw the property for a stated time, or to give the broker an exclusive agency. Even then, the owner may withdraw the property in breach of his promise,

but by doing so, of course, he incurs liability for damages.

We now return to the consideration of the scope of the agent's authority within which the principal is bound.

16. *Auctioneers.*—An auctioneer is an agent of the seller until the hammer falls. Thereafter, he represents the purchaser also, at least for the purpose of making a memorandum sufficient to satisfy the Statute of Frauds. He must follow the advertised terms of sale. He may sell only for cash, unless the terms of sale provide for the granting of credit. He may receive the price, or deposit in cash at the time of the sale, and, if it is not paid, sue for it in his own name. He has no implied authority to sell with a warranty.

17. *Lawyers.*—A lawyer is his client's agent to prosecute legal actions and proceedings and perform other legal services. His implied authority in all legal actions and proceedings is very broad, including the power to determine all the usual steps in the litigation, other than a settlement or discharge, of the cause of action. He must have express authority to compromise and settle a case. His client is entirely in his hands, as far as concerns all matters of procedure, or of remedy, and he is bound by what his lawyer does in these matters. The lawyer will be liable, however, for negligence or bad faith.

18. *Rights and liabilities of an undisclosed principal.*—If an agent, with actual authority to represent

a principal, makes a contract with a third party in his own name, but actually in behalf of his principal, a complicated situation results which has caused a great deal of controversy. It is settled law, however, that a true contract exists between the undisclosed principal and the third party, so that each may hold the other for breach of contract, the agent acting as the representative of the undisclosed principal in the making of the contract.

The third party, upon discovering who the principal is, may sue him, or the agent, at his election. He may hold the agent because the agent pretended to act for himself, and he is estopped, therefore, from denying his personal liability if the third party elects to hold him. The starting of a suit, even the recovery of a judgment and the issue of execution thereon against the agent, is not an election barring an action against the principal, if the third party does not discover the identity of the principal until later. If the principal sues the third party on the contract, the third party may set up any defense, offset, or counterclaim, that he could have set up in an action brought against him by the agent. This procedure is also the result of estoppel arising out of the false representation of the agent by which his principal is bound.

19. *Is the agent's misrepresentation legal fraud?* —Some cases hold that, if the agent affirmatively states he is acting as principal, and not as agent for his principal, when he knows that the third party, for

personal reasons, will not deal with his principal, the misrepresentation is fraud which gives the third party the right to rescind. It is settled, however, that he cannot rescind in the usual case if nothing is said as to the third party's objection to the principal. But the falsehood and its effects are the same in both cases.

The better, and prevailing, view is that the contract cannot be disaffirmed for fraud, because no damage results. The third party is fully protected by his right to hold the agent, and his right to all defenses, offsets, and counterclaims against the agent in case he is sued by the principal. At most, he is injured only in that he is tricked into a legal relationship with a person whom he does not like, an injury to his feelings, only; therefore, there is no fraud in the legal sense.

20. *Exceptions to doctrine of undisclosed principal.*—For technical reasons, it is held that the doctrine of undisclosed principal does not apply to contracts under seal, or to negotiable instruments. This is another application of the old principle that these instruments are something more than evidence of the contracts; they are, in a sense, the contracts themselves, and, therefore, no one not appearing in the instrument can be held liable on it, according to legal precedent.

In the case of negotiable instruments, certainly, and no doubt also in the case of contracts under seal, where the contract has been carried out by the third

person and the principal has received the benefits of his performance, the principal may be held on an implied contract. Otherwise, we would have the situation of a real beneficiary of a third person's performance of his contract receiving all the benefits without any liability.

Another limitation upon the doctrine which is rather indefinite and obscure in its application is that the action of a third party against an undisclosed principal is subject to the state of accounts between the principal and the agent. Some cases indicate that if the principal, acting in good faith, has settled with, credited, or paid the agent, the third party must look to the agent alone. This seems to be the prevailing American doctrine, which is based on a dictum in an early English case. The later cases in England repudiate this dictum and limit the doctrine to cases where the claimant against the principal has represented expressly, or by his conduct, that he has settled with the agent, thereby inducing the principal to pay the agent. The third party is then estopped from denying such settlement. This doctrine is sound. The prevailing American doctrine is unsound.

21. *Notice to agent is notice to principal.*—Anything brought to the attention of an agent in connection with the performance of his agency, which is material to the matter with which his agency is concerned, is notice to the principal. The reason for this provision is that the agent represents the principal for

all material purposes connected with the transaction, and the principal is bound, therefore, in the same way by notice to his agent of any matter that is material to the transaction, as though he had received it in person.

However, notice to an agent who is acting adversely to his principal, or in fraudulent collusion with a third person, does not bind the principal. The agent is not acting for the principal in such a case but is committing a wilful wrong for his own purposes and not in performance of his agency. The principal is not liable for the wrong, nor, in the corresponding case, is he chargeable with notice.

REVIEW

Outline the obligations of an agent to his principal.

Explain the status of an agent who acts for both parties without the knowledge of the double agency.

Give some illustrations of the type of services that an agent may delegate to another.

When does a real estate broker earn his commission?

What are the rights and liabilities of an undisclosed principal?

CHAPTER VIII

SECURITY

1. *Reinforcing an obligation.*—There are situations in which the law reinforces an obligation, as, for example, the obligation to pay a debt consisting of unpaid purchase money, by creating security for the performance of the obligation, through imposing a lien upon property, or giving a right to retain, or retake, possession of property.

There are also many situations in business practice in which the parties to a transaction provide for reinforcing the obligation of one (for illustration, one to whom credit is extended), through the contractual undertaking by another of liability, in case the former does not perform, or by placing property in the position of securing such performance. Some of these situations have already been dealt with.

In the chapters dealing with the sale of goods, we shall see how an unpaid seller may secure himself by means of negotiable bills of lading and like documents; by retaining title to the goods under conditional sales; and how the law gives him protection in certain situations by reason of his right to stop in transit and under a seller's lien. Again, in the chapter "Obligations of Parties to Negotiable Instru-

ments," we shall consider a form of security given by "accommodation indorsers." We shall not deal with these forms of security, at present, therefore, but shall turn our attention to other situations involving security.

2. *Real property mortgages.*—One of the most common means of securing a creditor is by giving him a mortgage upon land owned by the debtor. In form, the mortgage is a deed conveying the property to the creditor, called the mortgagee, as security for the performance of a promise to pay money, expressed in a bond or note. Under modern law, notwithstanding the form of the mortgage, the debtor, called the mortgagor, is regarded in most jurisdictions as continuing to own the land, the mortgage simply subjecting the land to a lien to secure payment of the debt.

Payment of the mortgage debt destroys the lien. Care should be taken when a mortgage debt is paid to secure a "satisfaction piece" to file in the public records where records of mortgages are kept, so as to clear the title from the incumbrance of the mortgage.

A tender of the amount due, which is not accepted by the mortgagee, also discharges the lien. In this situation, the debtor, on proof of the tender and refusal, and on paying the money tendered into court, may obtain a court order for the cancellation of the mortgage. If default is made in paying the mortgage debt when it falls due, the mortgagee may have the property sold under foreclosure proceedings and the proceeds applied to payment of the debt.

The mortgagor, in the absence of an agreement to the contrary, has the right to possession until default is made and, in most states, until the land has been sold under foreclosure. In Massachusetts and several of the New England states, the mortgagee is regarded as the owner of the land and, after default, is allowed to foreclose, or to recover possession from the mortgagor, and to hold the property until the debt is paid.

3. *Assumption of mortgage by purchaser of mortgaged property.*—When the mortgagor sells mortgaged property, this property continues subject to the mortgage. Usually, the purchaser promises to assume and pay the mortgage debt. If he does not assume the debt, the land continues subject to the mortgage, but the purchaser is not personally liable for a deficiency after foreclosure. If the purchaser assumes the mortgage (the amount of the mortgage debt being deducted from the purchase price), he is personally liable to the mortgagee if the seller of the land was himself personally liable. This situation further illustrates the promise made for the benefit of a third person as beneficiary, discussed in a previous chapter.

If the seller was not personally liable, however, a purchaser from him will not be liable personally to the mortgagee even though he assumes the mortgage. This fact may be made clear by example. Suppose A, the owner of land, gives a mortgage to another as security for a debt. In this case, A is personally liable

for the mortgage debt and, if he sells the property to B who assumes the mortgage, B also becomes personally liable. But suppose B had not assumed the mortgage and had, in turn, sold the land to C, who professed to assume the mortgage. Then C would not be liable to the mortgagee because his grantor, B, was not. The original owner, A, however, continues personally liable and the land remains subject to the mortgage lien.

A very important practical matter to remember, in these cases where there are conveyances of mortgaged premises, is that the liability of the original mortgagor on the note, or bond, after the mortgage has been assumed by a grantee, becomes that of a surety, so that an extension of the mortgage given by the mortgagee to the purchaser discharges all liability of the mortgagor, unless the mortgagor consents to the extension. This regulation exists because of the rule of suretyship under which extension of time to the debtor discharges the surety, unless the surety consented thereto.

4. *Chattel mortgages.*—Another form of security is found in the chattel mortgage. This form is very similar to the real estate mortgage, in effect, the mortgage in this instance being given by the owner of personal property. As in the case of the real estate mortgage, in most states, the debtor and owner of the goods mortgaged retains title throughout the life of the loan and is deprived of his title only in the event that he makes default in payment. In most cases, the

debtor also continues in possession of the goods, although in some cases the goods are delivered into the possession of the mortgagee.

As in the case of a conditional sale, described in a previous chapter, there are statutory requirements as to affidavits and acknowledgment and the chattel mortgage is required to be filed, or recorded, in some public office, to establish the mortgagee's prior claim as against other creditors of the mortgagor, or purchasers from him. The requirements of the various jurisdictions as to filing and recording of chattel mortgages and the methods of foreclosing the lien given by such a transaction differ widely. The local statutes should be consulted.

These statutes usually provide that, when possession of the mortgaged goods is not delivered to the mortgagee, the mortgage will be void unless filed or recorded, at least as far as third persons without notice are concerned. The filing, or recording, is usually required to be in the office of the town or county clerk where the goods are located, or where the mortgagor resides, or both, if these places are different.

In connection with chattel mortgages on stocks of merchandise, it is valid to provide that they shall apply to, and cover, after-acquired stocks. However, if this is the intent of the parties, the mortgage agreement should expressly so recite. In some jurisdictions, the statutes provide that a chattel mortgage on household goods, unless given to secure payment of

the purchase price, or a part thereof, will be deemed invalid unless signed both by the husband and the wife, and this regardless of which one may have actual title to the furniture.

5. *Pledges.*—A pledge is a contract by which the pledgor, continuing as owner, places personal property in the hands of a creditor, or, the property being already in the creditor's possession, is retained by him with the owner's consent, as security for a debt. Aside from form, perhaps the chief difference between a pledge and a chattel mortgage is that, in the former transaction, the goods are transferred to the possession of the pledgee, while in the latter case possession may or may not be transferred to the mortgagee, according as the parties provide. The term "pledge" is often applied to the article that is pledged, as is also the term "pawn." Pawnbrokers are pledgees. When the customer of a bank hands over securities to the bank to guarantee a loan, the pledge is known as collateral security. The relationship of pledgee and pledgor also arises between a broker and his customer where the farmer buys stock for the latter, and the latter puts up margin which he agrees to keep good.

Actual or constructive delivery to the pledgee of the thing pledged is essential. Constructive delivery is sometimes made by delivery of warehouse receipts, or bills of lading, under which the goods are held by a bailee.

The pledgee has a lien upon the goods up to the

amount of the debt secured by them. If the pledgee surrenders possession, except for a temporary purpose after which the goods are to be returned to him, he loses his lien. Unless otherwise agreed, when the debt secured by a pledge is paid, the creditor cannot retain the goods as security for some other debt, but must restore them to the pledgor. If, at its maturity the debt is not paid, the pledge may be sold by the pledgee. Out of the proceeds, he reimburses himself for the amount of the loan and expenses. Any surplus belongs to the pledgor. If there is a deficiency, the pledgee, of course, may sue to recover such amount from the pledgor.

The pledgee is bound to take ordinary care of the article pledged. He will be liable if it is lost or destroyed through want of ordinary care, or if he uses it in a way not contemplated by the parties, or otherwise than is necessary for its and his protection.

6. *Common law liens on chattels.*—Common carriers from early times have had a lien on goods carried, given to them by law as security for their charges. Innkeepers have had a similar lien upon the baggage and personal effects that a guest brings upon their premises. Hotels of all kinds, including apartment hotels and lodging houses, are covered in the term "innkeepers."

Artisans who have added value to a chattel by performing labor upon it, or by adding materials to it, likewise have liens for their charges and may retain possession of the chattel until paid for their services,

as do warehousemen for storage charges. A garage proprietor, for example, has a lien for storage charges as warehouseman, and a lien as artisan for work done upon a machine by himself or his employees.

By statute in many states, a lien is given to contractors, subcontractors, laborers and material men who perform labor on, or furnish materials for the improvement of real property, upon filing the prescribed notices. These statutes are known as "mechanic's lien laws" and contain many complicated provisions for the enforcement of such liens, which cannot be considered here. Mechanics' liens upon real property should not be confused with the common law artisans' liens upon chattels referred to in the preceding paragraph.

7. *Incidents of common law liens.*—The most important incident of a common law lien is that it is lost when possession of the goods is surrendered, and does not arise again, as to any further balance due, against goods of the debtor that subsequently come into the possession of the lienor. Thus, if a steam boiler is sent to a machine shop for repair and is returned to the owner before payment is made, the repairman's lien is lost. If, later, the same boiler or different machinery is sent to the repairman for new repairs, he cannot retain possession on account of the first charges, but must surrender the articles if payment is tendered for the repairs made upon the last occasion. He could sue, of course, for the amount of the first bill, but that would be his only remedy.

Permitting the owner to take away his chattel for a brief period—as an automobile for use during the day, to be returned at night—is not such a surrender of possession as involves loss of the lien. Possession is regarded as remaining in the lienor, the owner having only a temporary custody.

The cost of keeping the goods under a lien cannot be charged against the owner because they are kept by the lienor for his own benefit. In the case of a warehouseman, however, or a similar case of storage for an indefinite time, the cost of storage runs on until the charges are paid, since such charges come within the terms of the original contract.

Common law liens, originally, merely entitled the one having the lien to retain possession. They could not be enforced by a sale of the goods. Under modern statutes and decisions, such liens may be enforced by sale after notice, either through an implied power of sale, or under foreclosure. The procedure to be followed varies to some extent and the local law should be consulted.

8. *Commercial liens.*—Other liens have been developed by custom and decision of the courts, such as the lien of a factor for commissions and for advances made to the principal, and the lien of banks upon deposits for balances due from a depositor. The chief point of difference between such liens and those referred to above is that a commercial lien exists for the general balance on account due the factor or bank, irrespective of whether or not the items of such ac-

count are connected with the particular goods on which the lien is claimed. For instance, if a factor has earned commissions upon one bill of goods that he has sold for his principal, he may assert a lien for such amount against a subsequent lot of goods coming into his hands from the principal.

Factor's liens are enforceable by a sale of the goods. The factor may sell to satisfy his charges after giving reasonable notice to the consignor, even though the sale be against the express directions of the consignor and for prices lower than those authorized by him.

9. *Suretyship.*—A different form of security is afforded where one person, by contract, undertakes to answer for the "debt, default, or miscarriage" of another. One so undertaking is called a surety, and the contract is called a contract of suretyship.

Sometimes the word "suretyship" is given a more restricted scope. It is then confined to a direct and unconditional promise to the creditor, in contradistinction to a "guaranty" or collateral promise to pay the debt if the principal debtor does not. On the other hand, the word "guaranty" is sometimes restricted to a promise to pay if the debtor cannot pay, or is insolvent. In such a case, the promise is said to be a guaranty of collectibility.

These distinctions create confusion. They are important, in the main, only when suit is brought upon the contract. After all, a guaranty is merely a form of the contract of suretyship. We, therefore, use

the words "surety" and "suretyship" to cover every case in which the relationship involved is one's undertaking to answer for the debt, default, or miscarriage of another.

The terms of the promise of suretyship, and the circumstances under which it was made, must, in each case, be considered in determining the nature and extent of the undertaking. It is these terms and circumstances that determine whether the surety's promise is direct and unconditional, or is to pay if the debtor does not pay, or in the event that the creditor, after due diligence, is unable to collect, or if the debtor is insolvent, or under some other specified condition.

10. *Contracts of suretyship require writing.*—The Statute of Frauds requires a contract to answer for the debt, default, or miscarriage of another to be in writing and signed by the surety. Where the contract, though not in form, is, in substance, to pay the debt of another, the requirement of the statute applies.

The distinction between contracts that fall within the statute, that is to say, are required to be evidenced by writing, and those that fall without the statute, is oftentimes exceedingly fine. To illustrate: A contract to become a surety on a note is as much within the statute as is a present contract of suretyship. A contract to procure another to execute a contract as surety does not come within the operation of the statute.

It is the safest procedure, in all undertakings in which one party directly, or indirectly, reinforces another's undertaking, to have the contract reduced to writing. While prudence dictates the advisability of having all such contracts in writing, it may be observed that if, at the time the promise is made, there is no obligation or liability of the one undertaken for, or if the promise results in extinguishing the original obligation or liability, the promise does not fall within the statute. The statute applies only where there is an actual primary liability of a principal to the promise.

11. *Consideration.*—To be enforceable, a promise of suretyship, though in writing, must be supported, like any other promise, by consideration. Past consideration is not sufficient. Thus, if a merchant has sold goods, or lent money, to Smith, a promise given afterwards to pay, if Smith does not pay, will not be enforceable. It is without consideration. The merchant should either obtain the promise of the surety before or at the time of making the loan or sale, or give some new consideration if the principal transaction has already taken place.

12. *Notice.*—We have already observed the principle in the law of contract, that an offer must be accepted by the one to whom it is made in order that a contract be effected. This rule applies in the formation of contracts of suretyship. Jurisdictions differ, however, as to what constitutes an acceptance of an offer of suretyship.

In some jurisdictions, formal notice is unnecessary; acting on the offer suffices as an acceptance. In most jurisdictions, formal notice of acceptance is requisite.

Where the promise of suretyship relates to an existing contract, however, of which the promisor has knowledge, formal notice is not required. The same condition applies also where the promise is made simultaneously with the making of the contract to which it relates. Likewise, where the offer of the promise of suretyship is in the form of an absolute and definite undertaking, formal notice is not essential. This situation is illustrated, for example, by a communication by Smith to Jones by which the former writes to the latter, "If you let Alexander have goods of the value of $200 on three months' credit, you may regard me as guaranteeing his debt." Where the offer proceeds from the creditor, likewise, notice is not requisite. This situation may be illustrated by the case in which one applies to another for a loan, and is promised the loan if a designated person will become surety. This fact is communicated to the person so designated, who then makes the promise. Here the lender may act upon the promise without further assurance.

The safest course for the merchant to pursue is to notify the surety whenever he makes a sale, or loan, on faith of an undertaking of suretyship.

13. *Capacity to contract as surety.*—Capacity to contract as surety is governed by the general prin-

ciples of contractual capacity heretofore considered. In some states, however, under statutes removing the common law disability of married women to contract, exception is made in regard to their capacity to become sureties, especially for their husbands.

14. *How defenses available to principal affect the surety.*—The surety's right to avail himself of defenses open to the principal is restricted to "real defenses," that is to say, to such defenses as are inherent in the debt. Such right does not extend to defenses that are personal to the principal. The surety is bound, though the principal be an infant whose contract is voidable, or a married woman, where, by reason of that fact, she is not bound. Likewise, if the payee of a note is ignorant of the insanity of the principal, a surety is bound, even though the principal is not bound.

Real defenses, which, when available to the principal, are also available to the surety, may be illustrated by the case in which the principal's contract is tainted by illegality, and the case in which the principal is not bound because of fraud practiced upon him by the creditor.

15. *Notice of the principal's default.*—Notice to the surety of the principal's default is not generally necessary unless expressly made a condition precedent to the surety's liability. By the weight of authority, however, where the suretyship takes the form of a guaranty of an act which is indefinite as to time of performance, and of which the creditor would have

notice, and the surety not, a notice by the creditor to the surety of the happening of a default is required.

When notice is required, it must be given in a reasonable time. It is the part of prudence, in all cases, to give the surety notice, promptly, of the principal's default.

16. *Rights of co-securities.*—When there are two or more sureties similarly liable for the same debt, the law implies a promise by each surety to contribute proportionately to one who has paid more than his share of the indebtedness. The right of a surety to seek contribution from his co-surety requires that the one claiming contribution shall have paid the debt, or, in case of part payment, shall have paid in excess of his share.

17. *Rights of surety against principal.*—A surety who is obliged to pay the principal's debt is entitled to be reimbursed by the principal. Frequently, he is himself secured by having in his hands securities of the principal to indemnify him against loss. In such cases, of course, he can have recourse to these securities for reimbursement. The hardship of compelling the surety to pay the creditor, and thereafter seek redress against the principal, has been ameliorated by allowing him to proceed in a court of equity to enforce specifically the express, or implied, undertaking of the principal to indemnify the surety. By this means, the exoneration of the surety by the principal may be effected.

18. *Rights of surety against creditor.*—If the creditor has any security from the principal debtor, such as bonds, or the like, the surety who is obliged to pay is entitled to them in his own protection. This right is known as the right to subrogation; that is to say, the surety, on paying, is put in the place of the creditor as to securities so held by the creditor.

19. *Discharge of liability.*—The liability of the surety is discharged in the following ways, among others:

(a) A discharge of the principal accomplishes a discharge of the surety, unless a right is reserved to hold the surety. The principal may be discharged in one of the ways discussed in the chapter on "Performance and Discharge of Contracts."

(b) The creditor may discharge the surety by voluntary agreement to do so, i.e., release him.

(c) If the principal contract is altered materially, or a new agreement substituted for it, without the consent of the surety, the latter is discharged.

(d) A binding extension of time given to the principal debtor, without the consent of the surety, discharges the surety unless the creditor reserves a right to hold the surety.

(e) The surety is discharged when the creditor surrenders collateral security given to the creditor by the principal, to the extent, at least, of the value of the securities so surrendered. The same is true if the collateral is lost by the wilful act, or negligence, of the creditor.

(f) Tender of the debt and rejection thereof by the creditor discharges the surety, since the tender is equivalent to the performance.

(g) The surety is discharged, of course, if the debt is paid.

20. *Effect of surety's death*—The death of the surety does not terminate the obligation that he assumed by entering into the contract for suretyship. His estate is liable. The form of suretyship known as a continuing guaranty is a guaranty of debts incurred from time to time, rather than of some particular debt. Thus, if Jones guarantees the payment of any debt Smith may contract with the X Company during the current year, up to the amount of $1,000, the undertaking is one of continuing guaranty.

The guaranty is a mere offer, except in so far as it has been acted upon, and is capable, to this extent, of revocation by the guarantor. Accordingly, the guarantor is not liable for any credit extended after receipt of notice of revocation by the creditor. Death of the guarantor will have the effect of a notice of revocation.

REVIEW

State when the purchaser of mortgaged property is not personally liable for the mortgage debt.

What are the rights and liabilities of a pledgee?

Distinguish between common law liens and commercial liens.

Define suretyship.

Explain the rights of a surety against the principal debtor; against the creditor; against co-sureties.

Outline the ways in which a surety may be discharged.

CHAPTER IX

SALES OF PERSONAL PROPERTY—FORM OF THE CONTRACT

1. *Sales and contracts to sell.*—The most common transactions in business are those relating to the sale of personal property. Thousands of such transactions take place every day in every large community. At the outset, we notice two different types of such transactions—sales, and contracts to sell. Both transactions are based upon an agreement between the parties, the difference between them being that, in the case of a sale, the ownership or title to the goods involved is transferred by the seller to the buyer at the time of the bargain, whereas, in contracts to sell, the seller agrees to transfer ownership to the buyer at some future time.

Inasmuch as sales and contracts to sell are based upon agreement between the parties, the requisites as to the capacity of parties are the same as in contracts generally. The capacity of parties, particularly of infants, has already been discussed in a previous chapter of this Text.

The law of sales is governed in the majority of jurisdictions by what is known as the Uniform Sales Act, which has been adopted in twenty-seven states

at the date of this writing. Because of the wide adoption of this act, there is a large measure of uniformity in the law upon this subject. Some differences, however, are found in interpretation of the uniform act by the courts.

2. *Requisites of form.*—A part of the English Statute of Frauds, to which reference has been made in a previous chapter, applied to sales and contracts to sell. These provisions have been adopted substantially into the Uniform Sales Act. This statute enacts as follows:

(a) A contract to sell or a sale of goods or choses in action of the value of five hundred dollars or upwards shall not be enforceable by action unless the buyer shall accept part of the goods or choses in action so contracted to be sold, or sold, and actually receive the same or give something in earnest to bind the contract, or in part payment, or unless some note or memorandum in writing of the contract or sale be signed by the party to be charged or his agent in that behalf.

(b) The provisions of this section apply to every such contract or sale, notwithstanding that the goods may be intended to be delivered at some future time, or may not at the time of such contract or sale be actually made, procured or provided, or fit or ready for delivery, or some act may be requisite for the making or completing thereof, or rendering the same fit for delivery; but if the goods are to be manufactured by the seller especially for the buyer and are not suitable for sale to others in the ordinary course of the seller's business, the provisions of this section shall not apply.

(c) There is an acceptance of goods within the meaning of this section when the buyer, either before or after delivery of the goods, expresses by words or conduct his assent to become the owner of the goods.

3. *What is included within "sales of goods."*—The term "chose in action," which is used in the above section, has reference to any right of action to recover money or property capable of assignment under the law. Some choses in action, such as rights arising out of ordinary simple contracts, have no visible form; others, such as bonds, mortgages, and negotiable paper, have visible form and are commonly dealt with and transferred, like any tangible property.

The term "goods" has reference to personal property, not real estate. The Uniform Sales Act, as a whole, covers only the law relating to the transfer of personal property, not realty. The term "goods," however, includes growing annual crops, water, ice, manure, and fixtures annexed by a tenant for years, because such objects are regarded as things distinct and separate from land. This condition holds good, though they pass with the land as part of it when the land is transferred without reserving such objects. Therefore, a sale of, or contract to sell any of these things falls within the statute as a sale of "goods."

Fixtures, trees, or buildings which are contracted to be sold by the owner of the land after he has

severed them, become personalty instead of realty after the severance, and, therefore, such contracts also come within the statute. But if the parties agree to make a present transfer of fixtures, trees, or buildings, that is, if it is intended that ownership shall pass at the time of the bargain, the contract does not come within the section of the statute quoted above, because the agreement relates to the transfer of an interest in realty. This is usually the situation when the purchaser, rather than the seller, is to sever and remove the things. Such a contract, nevertheless, would be required to be in writing under that section of the Statute of Frauds discussed in Chapter IV which relates to contracts for the sale of, or concerning, an interest in land.

4. *Contracts for work and labor distinguished.*— A contract to perform work and labor is not a contract to sell goods, and does not fall within the section under discussion. Where goods are to be manufactured, there has been some difference of opinion as to whether the contract was for work and labor, or to sell goods.

The first part of subdivision (b) of the statute quoted above has cleared up this difference of opinion and shows that the usual contract by a manufacturer to sell goods which he regularly manufactures is considered one for the sale of goods and not one for work and labor, and therefore comes within the statute. An order placed by a jobber with a manufacturer, for goods similar to models and samples of

goods furnished by the manufacturer, has been held to be such a contract as would have to answer the requirements of the statute to be enforceable. The last part of subdivision (b), on the other hand, provides that the statute does not apply if the goods are not manufactured in the regular course of the maker's business, *and are not suitable for sale to others in the ordinary course of the seller's business.*

5. *Provision as to value of the goods.*—As drafted by the commissioners who prepared the Uniform Sales Act, the transaction, to be within the terms of the statute, must relate to goods of the value of $500 or more. A number of the state legislatures in adopting the act changed the minimum to $50 and other variations in amount are to be found. In applying this provision of the statute, successive, distinct purchases of different articles are regarded as separate and distinct contracts. But if the intention of the parties is to make only one contract, though several items are included, the sum total of the amount fixed must be taken in determining whether or not the statute applies.

6. *Acceptance and receipt of part of the goods.*—If part of the goods are accepted and received, no written memorandum is necessary to make the agreement enforceable. The reason for this provision is that such receipt and acceptance materially lessen the danger of fraud, because the transaction is evidenced in this way by overt acts. Receipt and acceptance, it should be noted, are not synonymous

terms. Frequently, the buyer receives the goods for the purpose of examination to see whether he will accept them or not. Receipt is the act of taking physical possession of the goods, but acceptance is evidenced by some act showing an intention to become owner of the goods. Acceptance is evidenced by any act of ownership, such as a resale by the buyer, or mortgaging, storing, or transporting the goods by him as owner.

When the goods are in the hands of a third person, such as a warehouseman, at the time of the transfer of ownership, there may be a receipt and acceptance by the buyer without any change of possession of the goods. The possession may pass to the buyer in any case, if the parties so intend, without a physical handing over of the goods. Whether there has been a transfer of possession is a question depending for answer on the facts of each case. To constitute such a transfer, it must appear that the seller has relinquished control and the buyer has assumed it. In New York, it is held that mere words are not enough to effect a change of possession. There must be some other act evidencing the assumption of control by the buyer. Notice to the warehouseman, and an agreement with him by the buyer to assume the payment of the warehouse charges, would be such an act.

Goods are often shipped by common carrier to the buyer, but while mere delivery to a common carrier may amount to a receipt by the buyer, it would not ordinarily amount to an acceptance by the buyer. He

would still have his right to examine before he could be deemed to have accepted. If, however, he has previously approved of the goods, after an examination before shipment, this constitutes an acceptance, and a delivery to the carrier thereafter would amount to a receipt of the goods.

The indorsement and delivery of a negotiable bill of lading, or warehouse receipt, to the buyer would amount to a receipt of the goods, because such documents control the possession of the goods, as will be seen in subsequent sections dealing with the nature and effect of such documents.

It should be added that the receipt and acceptance after an oral contract need not be immediate. The receipt and acceptance at any time after making the contract suffices.

7. *Part payment.*—Where there is part payment after an oral agreement, no memorandum is required to make the agreement enforceable. The price need not be payable in money, although it usually is. Exchanges or barters come within the statute; therefore, the part payment may be by the delivery to the seller of all, or part, of the goods to be given in exchange.

Notes and checks are not generally considered in the law to amount to payment, but are construed as conditional payment only until they are honored. Hence, the giving of a note or check does not constitute part payment within the meaning of the statute, unless it is clear that it was given and accepted in payment.

Generally, the time of part payment may be any time after the contract is made, as well as at the time the contract is made. In a few states, the statute requires the payment to be made at the time of the bargain.

8. *The memorandum in writing.*—Failing a delivery and acceptance of the goods by the buyer, or part payment, it is required that some note or memorandum in writing be signed by the party to be charged, or by his agent, or the agreement is not enforceable.

The note, or memorandum, may be made at any time before the action is begun, or even before the agreement is made. It need not be a formal writing, but may be in the form of letters, telegrams, and the like. It must give the names of the parties and set out the terms of the agreement. The property must be described and any additional terms such as express warranties must appear.

There has been controversy as to whether the consideration for the bargain must be described in the memorandum. The statutes of some states have settled the matter by providing that it need not be stated. The prevailing rule, aside from such specific statutory provisions, is that, if the consideration has been performed, it need not be referred to in the writing. But if the obligations of both parties are yet to be performed, the rule is that the memorandum must state the consideration.

Where the price has been paid, no memorandum

at all is necessary, because of the payment of the price, but, if the contract is executory, the payment of the price, or a tender of it, is a condition of the seller's promise, and the memorandum does not accurately describe the contract, or promise, unless the price is stated.

The memorandum must be signed by the party to be charged, or his duly authorized agent. Thus, if the seller is suing upon the contract, the buyer, or his agent, must have signed the memorandum. If the buyer is suing, the memorandum must have been signed by the seller or his agent.

REVIEW

Outline the provisions of the section of the Statute of Frauds relating to the sale of goods.

What choses in action are included within "sales of goods"?

Distinguish contracts for work and labor from contracts to sell goods.

Distinguish between acceptance and receipt of part of the goods as related to the requirements of the Statute of Frauds.

State the matters which should be included in the written memorandum.

CHAPTER X

SALES—PERFORMANCE—RIGHTS AND LIABILITIES OF PARTIES

1. *Delivery and payment of the price.*—The primary duties of the buyer and seller, under a sale or a contract to sell, are for the seller to deliver the goods and the buyer to receive and pay for them as the contract provides. In the absence of express provision to the contrary in the contract, such delivery and payment are concurrent conditions; that is, each must be ready, willing, and able, the one to deliver the goods on payment of the price, the other to pay the price on delivery. All these requirements are set forth in precise terms in the Uniform Sales Act. They are declaratory of the principles of contract explained in the chapter on performance of contracts.

2. *Time and place of delivery.*—Section 43 of the Uniform Sales Act provides as to the place of delivery as follows:

(a) Whether it is for the buyer to take possession of the goods or for the seller to send them to the buyer is a question of fact depending in each case on the contract, express or implied, between the parties. Apart from any such contract, express or implied, or usage of trade to

the contrary, the place of delivery is the seller's place of business, if he has one, and if not, his residence, but, in case of a contract to sell, or a sale of specific goods, which to the knowledge of the parties when the contract or the sale was made were in some other place, then that place is the place of delivery.

(b) When by a contract to sell, or a sale, the seller is bound to send the goods to the buyer, but no time for sending them is fixed, the seller is bound to send them within a reasonable time.

(c) Where the goods at the time of the sale are in the possession of a third person, the seller has not fulfilled his obligation to deliver to the buyer unless and until such third person acknowledges to the buyer that he holds the goods on the buyer's behalf; but, as against all others than the seller, the buyer shall be regarded as having received delivery from the time when such third person first has notice of the sale. Nothing in this section, however, shall affect the operation of the issue or transfer of any document of title to goods.

(d) Demand or tender of delivery may be treated as ineffectual unless made at a reasonable hour. What is a reasonable hour is a question of fact.

(e) Unless otherwise agreed, the expenses of, and incidental to, putting the goods into a deliverable state must be borne by the seller.

The above section is merely declaratory of the accepted rules of law as to the details of delivery, existing independently of the statute, and it sums the matter up clearly and adequately.

3. *Delivery to a common carrier.*—When, by the contract, the seller is to send the goods to the buyer,

delivery to the buyer is made by delivery to a common carrier for the purpose of shipment to the buyer, and title passes then. This condition prevails whether the buyer has specified the carrier, or whether the carrier has been selected by the seller. If a contrary intent appears, as when the carrier is directed to deliver on the seller's order, or if the seller undertakes to make actual delivery to the buyer, or at a particular place, or undertakes to pay the freight to a particular place, title does not pass and delivery is not made until the goods actually have been delivered to the buyer, or reached the place agreed upon.

In shipping the goods, the seller must protect the buyer by a contract on his behalf which shall be reasonable under the circumstances. If he fails to do so, such delivery to the carrier may be treated by the buyer as no delivery, or he may accept the goods and hold the seller for damages.

If the case is one in which it is usual to insure the goods in transit, and the seller knew or should have known this, the seller must give the buyer notice of the shipment in time to permit the buyer to insure the goods. If the seller fails to give this notice, the goods are at his risk during the period that they are in transit.

4. *Delivery of a greater or less quantity.*—If more goods are delivered than the contract calls for, the buyer may reject them all, or retain only those contracted for. If he keeps them all, he must pay for

them at the contract rate. If fewer goods are delivered than the contract calls for, the buyer may reject them; but if he accepts them, knowing that the seller does not intend to deliver the rest, he must pay for them at the contract rate. If he does not know that the rest of the goods will not be delivered, he is liable only for the fair value to him of those received.

If goods not included in the contract are delivered mixed with goods covered by the contract, the buyer may reject all, or accept those that he contracted to purchase, rejecting the rest.

All the foregoing provisions of the statute are subject to any special agreement of the parties, or custom of trade in modification of them. They are all simply declaratory of the principles of the law of sales established as prevailing law by the courts.

5. *Examination of the goods by the buyer.*—When goods that he has not examined are delivered to the buyer, no acceptance is deemed to take place until he has a reasonable opportunity to examine them. On tendering the goods, the seller must give the buyer a reasonable opportunity to examine them, but when no delivery is to be made by the carrier through whom the goods are shipped to the buyer, until the price is paid, there is no right of inspection until after the price is paid, since the contract requires payment before delivery. This is the case when goods are sent c.o.d., or when the buyer has agreed to honor drafts against bills of lading. If, later, the goods are found to be inferior, the buyer may reject

them and recover his money. The seller has no right, however, to ship goods on such conditions unless the contract's express terms, or a custom of the trade, permits it. If, then, the seller ships goods c.o.d., or under drafts against bills of lading, without authority, the buyer may reject them unless an opportunity is afforded to him to inspect before paying the price.

6. *Express warranties in sales.*—The Uniform Sales Act defines express warranty as follows:

> Any affirmation of fact, or any promise by the seller relating to the goods, is an express warranty if the natural tendency of such affirmation or promise is to induce the buyer to purchase the goods, and if the buyer purchases the goods, relying thereon. No affirmation of the value of the goods, nor any statement purporting to be a statement of the seller's opinion only, shall be construed as a warranty.

A warranty, therefore, may be a collateral promise amounting to a contract, or an affirmation of fact (as distinguished from a mere statement of opinion), upon which the seller expects the buyer to rely, the law making him liable as for a warranty, though no intent to make a promise expressly appears. Positive statements of fact as to quality are regarded as affirmations of fact and, therefore, as warranties.

The distinction between representations and warranties so often made in these cases has caused much confusion, but it is generally true that representations, as distinguished from warranties in the law, are merely expressions of opinion not intended as positive assertions of fact.

7. *Obvious defects; inspection.*—A warranty, in general terms, as a matter of interpretation, is held not to include obvious particular defects not specifically referred to in the warranty. This practice is observed because the parties probably did not intend the warranty to cover defects about which both must have known. It has been said that a warranty against an obvious defect cannot be enforced. This is not the law where the warranty takes the form of a collateral contract based on mutual assent and consideration.

If the warranty is based on a representation of fact not amounting to an express contract, but from which representation a warranty is implied by law because of the fraud that otherwise would be worked, there is a great deal to support the position that the one to whom such representation is made must make some effort to protect himself. On such a set of facts, he should not be protected by the law as against obvious defects readily discoverable by casual examination.

Where the defect is not obvious, but would be disclosed if a careful examination were made, and the buyer had the right to make the examination, but failed to make it, or failed to make it carefully, he is, nevertheless, protected by the warranty, whichever form it takes. He has the right in cases of express warranty to rely upon the seller's warranty, according to the prevailing law.

8. *Implied warranty of title.*—The Uniform Sales Act provides that, in a contract to sell, or a sale, unless a contrary intention appears, there is:

(a) An implied warranty on the part of the seller that in case of a sale he has a right to sell the goods, and that, in the case of a contract to sell, he will have a right to sell the goods at the time when the property is to pass

(b) An implied warranty that the buyer shall have and enjoy quiet possession of the goods as against any unlawful claims existing at the time of the sale

(c) An implied warranty that the goods shall be free at the time of the sale from any charge or encumbrance in favor of any third person, not declared, or known, to the buyer, before, or at, the time when the contract or sale is made

(d) This section, however, shall not be held to render liable a sheriff, auctioneer, mortgagee, or other person professing to sell by virtue of authority in fact, or law, goods in which a third person has a legal, or equitable, interest.

This act expresses the law as it generally prevails throughout the United States. Rights of action of all kinds, whether upon bonds, negotiable paper, stocks, etc., or rights of action on contract, in general, subject to assignment, are included. Barters are also included. The parties, by express provision, may exclude a warranty of title, and such exclusion will be implied where both know of the defect and make the contract on that basis.

9. *Implied warranty of quality.*—The act also provides that:

Subject to the provisions of this act and of any statute in that behalf, there is no implied warranty or condition as to the quality, or fitness for any particular

purpose, of goods applied under a contract to sell, or a sale, except as follows:

(a) Where the buyer, expressly, or by implication, makes known to the seller the particular purpose for which the goods are required, and it appears that the buyer relies on the seller's skill or judgment (whether he be the grower or manufacturer or not), there is an implied warranty that the goods shall be reasonably fit for such purpose.

(b) Where the goods are bought by description from a seller who deals in goods of that description (whether he be the grower or manufacturer or not), there is an implied warranty that the goods shall be of merchantable quality.

(c) If the buyer has examined the goods, there is no implied warranty as regards defects which such examination ought to have revealed.

(d) In the case of a contract to sell, or a sale, of a specified article under its patent, or other trade name, there is no implied warranty as to its fitness for any particular purpose.

(e) An implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade.

(f) An express warranty or condition does not negative a warranty or condition implied under this act unless inconsistent therewith.

If the goods are specified, the warranty of quality is implied by law rather than from any inferred agreement of the parties, and it will be implied, therefore, only in those cases where justice and fair dealing require it. It must appear that the buyer, in purchasing the goods, relied, and had the right to rely, upon the skill or judgment of the seller.

This condition is held to be the case when the seller is the manufacturer of the goods, and therefore is in a position to know all about them. In England, and in many of the states, the same rule applies to sales by a regular dealer in the goods, and for the same reasons.

Many of the states, however, have refused to extend the rule to sales by dealers, though this situation is now changed in such states as have adopted the Uniform Sales Act. This act extends the rule to all cases in which it appears that reliance was had, in fact, upon the skill or judgment of the seller, whether he be dealer or manufacturer.

When the goods are bought by description, it is a plainly implied term of the contract that only merchantable goods of the specified description are intended, and the warranty is therefore based on the true intent of the parties. In both cases, no such warranty should be implied when the buyer has an opportunity to inspect the goods and a reasonable inspection would disclose their defects.

The warranty that the goods are fit for the purpose for which they are purchased is based on the same principles as the warranty of merchantable quality.

10. *Goods that meet the contract.*—When the contract is for the purchase of a definite thing known to both parties, or definitely described in the contract, so that it cannot be reasonably inferred that the buyer relied upon the seller's special judgment or skill, no

warranty is implied. It is a question of fact in each case, turning on whether or not the parties understood that the seller's special knowledge or skill was relied upon.

The seller warrants, generally, that the goods are merchantable and fit for the general use for which they are intended, but not that they are fit for the specific use to which the buyer intends to put them. Thus, for example, a sale of a specified boiler and 320 square feet of radiation carries with it no warranty that it will heat the house of the buyer. A different result will follow if the seller has estimated the size of boiler and amount of radiation required to heat the house, because the buyer would then have relied on the skill and special knowledge of the seller.

11. *Warranty regarding food.*—No warranty that food sold by a dealer for immediate consumption is fit, is included in the general provision of the Uniform Sales Act. Yet, in states that have not adopted the act, and in which dealers are not charged with warranty of quality, it is well settled that dealers are bound by warranty that such food is fit for consumption as intended.

12. *Merchantability.*—The term merchantability means only that the goods are readily salable as goods of the quality or grade that they are supposed to be, not that they are of first quality.

13. *Sales by sample.*—An implied warranty arises on a sale by sample. Such warranty gives the buyer an action for damages if the bulk of the goods does

not correspond with the sample in quality. It implies that the buyer shall have reasonable opportunity to compare the goods with the sample and that, if the seller is a dealer in the goods, he warrants against defects rendering them unmerchantable.

In New York, under the Uniform Sales Act, it has recently been settled that there is an implied warranty of fitness when food is sold by a dealer, if it appears that the customer relied upon the seller's skill and judgment.

14. *Warranty against the immediate vendor.*—The general rule is that, if there is a breach of warranty, the purchaser may make his claim only against the one from whom he purchased. Thus, if a retail customer buys from a druggist, or other retailer, an article which is unfit for use, under such circumstances that it appears that there was an implied warranty of fitness for a particular purpose, he may recover only on the contract as against the retailer. He cannot sue the manufacturer or middleman.

15. *Buyer's remedies against seller.*—When the seller fails, or refuses, to transfer title to the buyer, or to deliver the goods if title has already passed, the buyer is entitled to damages. The measure of damages, as a rule, is the difference between the contract price and the market price at the time and place when the goods should have been delivered. In rare cases, there may be special circumstances showing proximate damages of a greater amount than would be found by applying the above measure. Under

these circumstances, the buyer may recover the damages actually suffered.

If title has not passed, and the seller has failed, or refused, to transfer it, the buyer may also rescind the agreement, refuse the goods, and recover back any part of the purchase price that he has paid.

If title has passed, the buyer is entitled to possession if he is not insolvent and is ready to carry out his part of the bargain, and he may choose to have the goods themselves rather than damages. If so, he may secure the possession by a legal proceeding known as an action of replevin. But if title has not passed, the buyer cannot force the seller to transfer the goods unless they are of a special and peculiar kind not readily obtainable in the market.

The exceptional cases are very rare, so that, ordinarily, the buyer must rely on his action for damages, or his right to rescind the contract, if the seller neglects or refuses to perform and title has not passed.

16. *Remedies for breach of warranty.*—In some jurisdictions, before the Uniform Sales Act was adopted, the only remedy the buyer had for a breach of warranty was to reject the goods when they were tendered, and sue for damages. Acceptance of the goods, even if protests were immediately made, was held to be a waiver of the breach of warranty, at least if the defects were apparent on inspection. Other jurisdictions held that acceptance of the goods did not bar the buyer from a right of action to recover

damages for a breach of warranty, provided notice was given to the seller within a reasonable time. The Uniform Sales Act has adopted, in substance, the latter view.

At present, in most states, the buyer may accept the goods and give prompt notice of any breaches of warranty that he may find, and have damages therefor. The measure of damages for a breach of warranty is:

> . . . the loss directly and naturally resulting in the ordinary course of events, from the breach of warranty. In the case of breach of warranty of quality, such loss, in the absence of special circumstances showing proximate damage of a greater amount, is the difference between the value of the goods at the time of delivery to the buyer and the value they would have had if they had answered to the warranty.

17. *Seller's remedies: lien.*—We have seen, in a previous chapter, how the seller may secure himself by shipping goods under negotiable bills of lading. Another method given him to secure payment of the price is by a lien. When the title has passed to the buyer but possession remains with the seller, the latter may retain possession of the goods until the price is paid, unless a period of credit has been given to the buyer by the agreement. If, however, title has passed and credit has been given to the buyer, the latter then has the right to demand possession of the goods without tendering payment, provided he is not insolvent. If insolvency of the buyer occurs, how-

ever, during the period of credit, the seller's lien immediately arises and the seller may continue to hold possession of the goods. The seller's lien attaches, likewise, if the period of credit expires without payment.

Insolvency sufficient to give rise to a seller's lien during a period of credit does not require that the buyer commit an act of bankruptcy. It suffices that the buyer is unable to pay his debts in the ordinary course of business.

If the possession, as well as the title, of the goods has passed to the buyer, the seller cannot exercise any rights of lien, except in the case where the goods are in transit to the buyer.

18. *Stoppage in transitu.*—The Uniform Sales Act provides that:

> When the buyer of goods is, or becomes, insolvent, the unpaid seller who has parted with possession of the goods has the right of stopping them *in transitu*, that is to say, he may resume possession of the goods at any time while they are in transit, and he then becomes entitled to the same rights in regard to the goods as he would have if he had never parted with the possession.

The right is exercised by giving notice to any proper agent of the carrier, instructing the carrier to stop the goods and withhold delivery. The notice must be given, however, to the agent of the carrier so as to enable him, by the exercise of reasonable diligence, to communicate it to the agent who has the custody of the goods in time to prevent the delivery to the consignee.

The transit, during which the seller may exercise his right to stop the goods, must be between the seller and the original buyer. If it is between the seller and one who purchased from the original buyer, the prevailing rule is that there is no right to stop. If the goods are carried under a negotiable bill of lading, which has been negotiated by the buyer to a bona fide purchaser, that is, a purchaser in good faith, the seller's right is also cut off. If the seller knows of the buyer's insolvency when he shipped the goods, he then has no right to stop.

19. *Making the lien effective.*—The unpaid seller who is in possession of goods under a lien, or after stoppage *in transitu,* that is, during passage or shipment, would be but little benefited if all he could do were to hold the goods. He may make a choice, therefore, of several remedies to make the lien effective. Since title has passed, he may bring an action for the price, and the recovery of judgment will not put an end to the lien; only the tender of the price will accomplish that result. Frequently, it would not be of advantage to the seller to bring an action for the price, because a judgment would probably be uncollectable. Hence, a seller with a lien, having stopped *in transitu,* may resell the goods, after waiting a reasonable time, and sue for damages. Notice of the time and place of resale should be given to the buyer, but this notice is not required. If the resale is fairly made at as good a price as he can get, the seller's damages generally will be the difference

between the resale price and the contract price. He may also recover, as additional damages, reasonable expenses incurred while holding for the buyer for a reasonable time under the lien.

The seller may also choose to rescind the transfer of title, thus making the goods his own again, and sue for damages. If he chooses this remedy, he must give notice of his election to rescind, or manifest it in some way. The damages will be the difference between the market price and the contract price.

20. *Seller's remedies in other situations.*—If neither title nor possession has passed to the buyer, the goods, of course, are the seller's own to do with as he pleases. If the buyer defaults in payment in such a case, the seller may sue on the contract for *damages,* provided always that he was willing, ready and able to perform on his own part.

He may also sue for the *price* in two cases:

(a) If the goods are not readily resalable, and the buyer has refused to accept the goods after tender by the seller. Notice of intention to hold as bailee for the buyer must be given. (In this case, and in this case only, he may thrust title upon the buyer, without the buyer's consent. Such cases are comparatively rare, because there usually is a market for goods dealt with in ordinary commercial transactions.)

(b) If the agreement called for payment on a day before title was to pass, or on the happening of a condition. These cases also are only infrequently found in commercial transactions.

When both title and possession have passed to the buyer, the seller may sue for the whole price.

When possession has passed to the buyer, but not the title—the so-called "conditional sale" transaction —the seller has special remedies that are given him under the Uniform Conditional Sales Act. These remedies will be considered in the chapter on "Conditional Sales."

REVIEW

Outline the provisions of the Uniform Sales Act regarding time and place of delivery.

What rights of examination has the buyer?

Name the warranties that are implied under the Uniform Sales Act.

Explain the remedies of the buyer against the seller.

State the remedies of a seller under his lien.

When may the seller sue for the price?

CHAPTER XI

SALES—TRANSFER OF OWNERSHIP AND RISK

1. *Transfer of ownership.*—If a valid sale or contract to sell has been made, it may be of the utmost importance to determine when ownership—or title, as it is called—passes from the seller to the buyer. If the title does not pass to the purchaser at once, the general rule is that the seller bears the risk of the loss of the article before delivery. His creditors may seize the property, and, until the title passes, the seller is entitled to appropriate any gain or increase that may arise. When title passes to the purchaser, however, the risk of loss is his, though the goods are still in the possession of the seller, provided the loss is due to no fault of the seller or it has not been agreed that the risk of loss shall remain with the seller until delivery. So, also, if title has passed, the creditors of the seller have no more right to the goods than the seller has, even though possession remains with him, unless the transaction amounts to a fraud on the creditors.

Whether or not, in a particular case, the title has passed, depends upon the intention of the parties or upon presumptions as to what their intention would have been had they thought about the matter.

2. *Unidentified goods.*—Obviously, the ownership of goods cannot be transferred from one party to another until the goods which are the subject matter of the transaction have been identified. Thus, if A agrees to sell and B agrees to buy one hundred cattle out of a herd of a thousand belonging to A, it cannot be determined which particular animals are to become B's property until the one hundred have been identified by selection. The selection is usually made by the seller, but it may be understood or agreed that it is to be made by the buyer. Until it is made, ownership does not pass.

It is true that the parties may, if such is their intention, become owners in common of an identified mass of goods. But, in such case, neither party can point to any particular units of the mass and say "Those are mine." In such case, each common owner owns his agreed share of *each* unit. Tenancy in common of personal property is comparatively rare in ordinary commercial dealings, and it is seldom that the parties to a bargain intend ownership in common.

3. *"Fungible" goods.*—An apparent but perhaps not a real exception to the rule that title cannot pass until the goods are identified is to be found in the case of so-called "fungible" goods. In such a case, the goods may be identified by quantity. Fungible goods are those of which any unit of a mass is the natural equivalent of every other unit or is so treated by mercantile usage or by agreement of the parties.

Goods which are usually sold by weight, measure, or number—like wheat, oil, coal and bricks of the same grade—are fungible goods. Such articles as chairs, desks, automobiles, fur coats, etc., would not ordinarily be regarded as fungible goods. When the goods sold and bought are fungible, there may be a present transfer of title, if the parties so intend, without a separation of the goods sold from a larger mass, provided the seller owns the mass and the mass is identified and is of one quality or grade. If the mass contains less than the number, weight, or measure bought, the buyer becomes owner of the whole mass and the seller is forced to make good the deficiency unless a contrary intent appears.

Although the parties may not specifically agree to become owners in common in such cases, if they deal with an identified mass of fungible goods owned by the seller under such circumstances that it appears that the seller intends to transfer ownership and the buyer to take ownership of a part of the mass, the parties become owners in common. Consequently, if the mass diminishes through loss, the buyer's share must suffer in proportion to his interest. So, if A agrees to sell, and B agrees to buy, 250 bushels out of a mass of 1,000 bushels of wheat, the buyer becomes owner of one-fourth of the whole. Should three-quarters of the wheat be destroyed without fault of either party, the buyer will be entitled to only one-quarter of the remaining 250 bushels (unless it clearly appears from the bargain that he was

to have an indefeasible right to the amount purchased) and he will be obliged to pay the full agreed price.

4. *When the goods are ascertained at the time of the bargain.*—When there is a contract to sell goods which are identified at the time of the bargain, the ownership of them passes to the buyer, if the parties so intend. This intention is determined from the terms of the contract, the conduct of the parties, the usages of trade, and the circumstances of the case. Frequently, the parties are not thinking of the exact time that ownership is to pass and say nothing about that point in their agreement, and there may be no usages of trade or other circumstances to aid the courts in arriving at their intention. For that reason, the law has been forced to develop certain presumptions which will control, unless some evidence of intention appears in the facts of the case to rebut the presumption. The first of these presumptions is that, when there is an unconditional contract to sell specific goods which are in a deliverable state, title passes when the bargain is made. This is true even though the time of delivery or the time of payment, or both, be postponed to a later date. Thus, if the buyer views a particular machine offered him by the seller, and agrees to buy it on these facts standing alone, title will pass to him at once, though he is not to pay for 30 or 60 days and though delivery is not to be made for two weeks. Any loss of the goods before delivery will fall upon the buyer.

5. *When something is to be done by the seller.*—The next presumption developed is that, if there is a contract to sell specific goods and the seller is bound to do something to the goods for the purpose of putting them into deliverable state, the title does not pass until the thing is done. So, in the case of the machine, if the seller is to make certain repairs or alterations after the bargain, title will not pass until his work is done, and a destruction of the machine in the interim will be the seller's loss, since the ownership is still with him.

Weighing or other measuring solely for the purpose of determining the price, it should be noted, is not something that is to be done to put the goods in a deliverable condition within the meaning of this rule.

6. *"Sale or return" and "sale on approval."*—Besides making an agreement for an out-and-out sale, the parties may agree that the property or title shall pass to the buyer upon delivery but that he may return the goods if they are not satisfactory. This type of bargain is called one "on sale or return." In such a case, ownership passes subject to being revested in the seller at the buyer's election, if he chooses to return the goods. The risk of loss passes to the buyer along with the title.

On the other hand, the agreement may be that the buyer shall take possession of the goods to see whether they are satisfactory to him, and, if they are not, that he may refuse to become owner. This type of trans-

action is called a sale "on approval" or "on trial," or "on satisfaction." The title and risk of loss then remain with the seller, until the buyer has made his decision or has so conducted himself as to appear to have decided to become owner.

Whether the transaction is of one type or the other depends on the apparent intention of the parties and is often a difficult question of fact.

Usually, in both cases, the duty rests on the buyer to return the goods if he determines to do so; but the agreement may provide that the seller is to send for them. In a bargain "on sale or return," if the agreement fixes the time at which the buyer must exercise his option and he uses the goods beyond that period of time, such use will be construed as expressing an election to keep the goods. If no time is named, he has a reasonable time. In an "on approval" bargain, if the agreement fixes a time within which disapproval shall be manifested, he must indicate his intention not to become owner within that time. Frequently, the contract fixes the time for trial, but is silent as to when disapproval must be indicated. If this is so, the buyer has the full time for trial, but must give his notice immediately thereafter. A use of the goods beyond the time fixed, as a general rule, will be consistent with a subsequent election to return the goods.

7. *"Cash sale."*—The term "cash sale" is used to describe two different sorts of contracts, viz., one in which payment of the price is a condition precedent

to the transfer of *title,* and one in which payment of the price is a condition precedent to the buyer's right to *possession* of the goods. Because of this double use, the term is confusing. The first type only is a true cash sale. The phrase "terms cash" is just as confusing. In one instance, it may mean that title is not to pass until the price is paid, and, in another, it may mean merely that a short period of credit is given. When shopkeepers make an "over-the-counter" sale, we have a transaction that we can safely call a cash sale. Again, when it appears that payment, delivery, and the transfer of ownership are all to be simultaneous, the transaction would be a cash sale in the true sense of the term. Very frequently goods are shipped by carrier and are invoiced "terms cash." What is probably meant in the majority of cases is that title passes to the buyer on delivery to the carrier and that there is to be a short period of credit, not that title is not to pass until payment is made. Custom of the trade is important and usually controlling in these cases.

On the whole, it may be said that the expression "terms cash" is not very useful in determining when title passes. The question will turn on other facts and circumstances and upon the presumptions that have been heretofore and are to be hereafter developed.

8. *Contract to sell unascertained goods.*—We have seen that when the parties deal with identified goods the presumption is that title passes when the bargain

is made. Many agreements are made, however, to buy and sell goods which are not ascertained at the time of the bargain because not selected from a mass of non-fungible goods; or which are to be manufactured or acquired by the seller after the bargain is made. In the nature of things, title cannot pass when the bargain is made. When will it pass?

Here, too, the intention will govern, if the actual intention appears. If the intent cannot be found, the law has developed still other rules to settle the question. The primary rule is that title will pass at the moment when the goods have been ascertained and have been applied to the contract with the mutual assent of both parties expressed by word or inferred from their conduct. Thus, if the seller has manufactured or procured the goods which he *intends* to apply to the contract, before title can pass, he must indicate by some unequivocal act that these *are* the goods to be appropriated to the contract, such as by packing them and tagging them with the buyer's name. This is only the first step, however, as the buyer's assent to become owner of the same goods must be found. This assent may be given before or after the seller's act is done, and may be express or implied. It is usually gathered from the circumstances of the case. Some general rules, however, can be laid down for particular classes of cases.

9. *Goods shipped by carrier.*—If the goods have been ordered to be shipped by a carrier, appropriation by the seller with the assent of the buyer is pre-

sumed to take place when the seller has done his last act, i.e., delivered the goods to the carrier for shipment to the buyer. But title will not pass at that moment, unless the goods are shipped in conformity with the contract, that is, are of the kind and quantity ordered, are properly packed, are shipped by the proper route, and the seller has made a contract with the carrier which properly protects the buyer's interest.

10. *F.o.b. stipulations.*—When the goods are shipped f.o.b. point of shipment, the rule of the last section applies. But, if the goods are to be shipped f.o.b. point of destination, title is not presumed to be intended to pass until the goods reach the destination. (F.o.b. means free on board, that is delivered on board free of charges.) Thus, if an automobile is purchased by an order given in New York to be shipped f.o.b. Detroit, title will pass to the buyer when the goods are put on board the car in Detroit, as that is the seller's last act required by the agreement. If the auto is destroyed in transit, the loss will fall upon the buyer. But, if the car is to be shipped from Detroit, f.o.b. New York, the seller's obligations are not fulfilled until the car reaches the freight station in New York. In such a case, the seller pays the transportation charges, whereas in "f.o.b. point of shipment" cases, the buyer pays the transportation charges.

11. *Other situations.*—Sometimes the contract requires that the seller is not only to pay the transpor-

tation charges over the railroad, but is to deliver the goods to the buyer's place of business or to some other specific place. The point of delivery will be the place where the title will pass, since the seller's last act is not done until he makes delivery there and the buyer has had suitable opportunity to examine the goods.

Title to goods shipped "cash on delivery" passes to the buyer when delivered to the carrier, according to the terms of the Uniform Sales Act, although the rule was different in some states before the act was adopted. Shipment c.o.d. is construed as giving the seller control over the *possession* of the goods with a lien for the price. Title and the risk of loss are in the buyer from the time of delivery to the carrier.

12. *Effect of bills of lading.*—The rules governing the various situations discussed in the above sections may be considerably modified by the presence in the transaction of bills of lading. These documents are issued by railroads and shipping companies and are quite commonly used in the commercial world. A bill of lading performs several functions. It is a receipt for the goods issued by the carrier, it also contains the contract of the carrier to deliver, and it may have important effects upon the passing of title.

Warehouse receipts are similar documents except that they are contracts for storage rather than carriage, but otherwise are governed by the same rules as are bills of lading.

These documents take two forms:

(a) Negotiable ones, which state that the goods described therein will be delivered to bearer or to the order of someone named in the document
(b) Non-negotiable, or "straight" documents, in which the undertaking is to deliver the goods to the consignee named therein, without any "order" words

The carrier or warehouseman who has issued a non-negotiable document may deliver the goods to the consignee named in it without requiring the production and surrender of the document. But he cannot surrender goods held under a negotiable document to the person named as consignee without its production and surrender, because that person may have negotiated the document to another and because a negotiable document controls the possession of the goods. The form of the document may also control the passing of title.

Non-negotiable documents are not of such interest as to warrant a treatment here, but the effect and use of negotiable documents deserves some attention.

13. *Use of negotiable documents by a seller.*— Negotiable bills of lading and warehouse receipts are transferred by indorsement in the same manner as are drafts, notes, and checks. The Supreme Court of the United States has said that bills of lading "are so much cotton, grain, iron, or other articles of merchandise, in that they are symbols of ownership of the goods they cover." The delivery of such documents is in effect a delivery of the goods themselves. For this reason the seller of goods that are shipped

under a negotiable bill of lading is able to retain a hold upon the goods. He can do this in various ways:

(a) By taking an order bill in his own name (that is, the carrier makes the bill out "to Seller or Order") and indorsing it in blank and sending it, with a draft on the buyer for the price, to a bank or other agent in the buyer's city with instructions to hold the bill until the draft is paid or accepted. Frequently the seller discounts the draft with his own bank, which takes the bill of lading, indorsed to itself or in blank, as security. The discounting bank then forwards the bill of lading and the draft to a correspondent bank in the buyer's city. If the buyer accepts or pays the draft, the bill of lading is turned over to him. Then, but not until then, the buyer is able to get the goods. By this practice the seller is enabled to get the use of the purchase money promptly by discounting the draft on the buyer with his own bank. The discounting and correspondent banks, by having the bill of lading in their possession, have control of the goods as security. The title to the goods in such a case is called a "security title" and is in the party holding the bill of lading, that is, the banks.

When only a security title is held, as in the above situation, the risk of loss is not with the holder of the title, but falls upon the buyer of the goods. The reason for this is that, except for the form of the bill of lading, the title would have passed to the buyer on shipment, and it is retained solely to secure the seller or the discounting banks.

(b) By taking a bill of lading to the order of the buyer and sending it to a bank or other agent in the buyer's city, together with a draft for the price, with instructions not to deliver the bill to the buyer until the draft is paid or accepted. In such a case the title passes to the buyer on shipment and the seller retains a lien on the goods by reason of controlling the possession of the goods through the bill of lading.

(c) By taking a bill of lading running to his own order,

or to the buyer's order, and sending the bill directly to the buyer with a draft attached. This practice is dangerous. The law is, that the buyer is bound to honor the draft or return the bill of lading, but the buyer, holding the bill of lading, has it in his power to obtain the goods from the carrier. He may then sell them to an innocent purchaser for value or, instead of obtaining the goods, he may negotiate the bill to an innocent purchaser for value. In either case the innocent purchaser would get title to the goods and the original seller could not claim them, though the buyer has not honored the draft for the price, as the seller had intended he should, before dealing with the goods.

14. *Obtaining a document of title by fraud or theft.*—If one obtains an outstanding negotiable bill of lading or warehouse receipt by fraud and negotiates it to a bona fide purchaser for value, such a purchaser will obtain a good title which cannot be disturbed by the defrauded person. Under the Uniform Bill of Lading Act, which has been adopted by a number of states, and by Congress, and hence extends to interstate shipments, even a thief can negotiate a negotiable bill of lading to an innocent purchaser for value and give him a good title against the owner. This is more than the thief could accomplish by selling the goods themselves, since a purchaser of goods from a thief gets no title whatever and the true owner can come and take them from him without compensation.

15. *Transfer of non-negotiable bills of lading and warehouse receipts.*—The transfer of a non-negotiable document of title is only an assignment of such rights as the owner of the document has, and the

transferee takes, subject to all infirmities of title. There is, however, one exception to this rule under the Sales Act. If a "straight" or non-negotiable bill of lading is sent with a draft for the price directly to the buyer and he wrongfully sells the bill to an innocent purchaser for value without first honoring the draft, the purchaser gets a perfect title as against the first seller.

16. *Trust receipts.*—There is a growing practice, particularly in connection with importing goods from abroad but by no means confined to such cases, of using documents that are called trust receipts. Goods are shipped from abroad under ocean bills of lading indorsed in blank and with drafts attached which come to the hands of a bank in the buyer's city. The buyer may need to get possession of the goods promptly, in order to use them for manufacture and to sell the product before he can honor the draft. If he is well regarded by the bank, it may turn the bills of lading over to him, thereby enabling him to get possession of the goods. To secure itself for the money it has loaned to the seller in discounting his draft upon the buyer, the bank will take back from the buyer a trust receipt. This document provides that the title to the goods shall be in the bank until the draft or price is paid. The bank will then have title for security and, as under the security bill of lading, the risk of loss will be upon the buyer.

17. *Factor's Acts.*—The general rule is that a sale of goods made by a person without title is void as

against the true owner and he may recover them from the innocent purchaser. We have noted an exception to this in the case of transfers of bills of lading. The so-called Factor's Acts which have been adopted in most of the states also modify the general rule. These provide that unauthorized sales of goods left in the possession of a factor will bind the owner, if made to a purchaser for value without notice of the owner's rights. The reason for the rule is that the owner is deemed to have held out the factor as having general authority to sell, a species of statutory estoppel. The Factor's Acts have extended the doctrine to the pledging of such goods by a factor, so that the owner cannot recover the goods until the loan to the factor, which the goods secure, has been paid. This item is discussed in the chapter on the law of agency.

18. *Sale by a seller left in possession of goods.*—Another species of statutory estoppel is defined in that section of the Sales Act which provides that, when a seller who has sold goods continues in possession of them, or of negotiable documents of title to the goods, the *delivery* or transfer by such seller, or by an agent acting for him, of the goods or documents of title under any sale, pledge, or other disposition, to any person receiving and paying value for them, without notice of the previous sale, will bind the first buyer.

19. *Risk of loss.*—Throughout the several preceding sections, we have noted that the risk of loss generally follows the title except when the title is held

merely for security. This rule, however, may be changed by express agreement, in any way that the parties may desire. It should be added that the Sales Act provides that, if delivery is delayed by fault of either party, the risk of loss is with the party so at fault, if the loss is one which might not have occurred had delivery not been delayed.

20. *Effect of fraud on the seller.*—A seller may be induced to sell his goods by fraud of various sorts. In such cases, the general rule is that a voidable title passes to the defrauding buyer, which can be rescinded by the seller, if the goods have not been resold for value to a purchaser who had no notice of the fraud. Such an innocent purchaser can keep the goods against the defrauded seller, who will have to seek damages from the defrauding buyer, if he can find him.

Sometimes the fraud practiced takes the form of impersonation. Thus A comes to B and represents that he is X, known by reputation to B as a person of good credit. B is induced to sell the goods on credit. A voidable title passes to A. This is only true, however, if the dealing is a face-to-face transaction. Thus, if, by letter, A orders goods to be sent to a certain address, representing himself to be X, a person of good credit, no title of any kind passes to him and the defrauded seller can pursue the goods into the hands of an innocent purchaser and take them from him. The same is true, if A, in a face-to-face transaction, falsely represents himself as agent of X.

The distinction between these last two cases and the first case is that, in the first, the seller intended to give title to A who stood before him even though he thought A was X, but that, in the latter two cases, the seller intended to give title to X, not to A. The distinction is of questionable validity, but it is quite well established in the cases.

21. *Conditional sales.*—In the case of conditional sales, title is reserved in the seller as security for the price, the possession passing to the buyer. The incidents of conditional sales are considered in a separate chapter under that title.

REVIEW

What is meant by the phrase "passing of title"?

What presumption exists as to the passing of title when the goods are ascertained at the time of the bargain?

Distinguish between "sale or return" and "sale on approval" and explain their incidents.

Explain the effects of the stipulations: "f.o.b. point of destination"; "f.o.b. point of shipment"; and "c.o.d."

Outline the use and effects of order bills of lading.

CHAPTER XII

CONDITIONAL SALES AND SALES IN BULK

1. *Nature of conditional sales.*—The decade since the close of the Great War has seen an enormous growth of the practice of selling goods under conditional sales agreements—the so-called installment sales. All sorts of dire prophecies as to the economic results of this practice have been made from time to time, but, on the whole, such prophecies have not been fulfilled. Whatever the economics of installment sales may be, they have become such a common feature of commercial transactions as to merit treatment separate from the law of sales generally. This chapter, therefore, will deal with the general principle of the law of conditional sales, and a reference will also be added as to the law of bulk sales.

A conditional sale is one under which possession of goods is delivered to the buyer, but the title is reserved by the seller pending, and as security for, payment by the purchaser of the full purchase price. The buyer gets immediate possession and retains the right to possession as long as he continues to make his payments in accordance with the terms of the contract, which usually, but not necessarily, provides for payment in stipulated regular installments. The

ownership or title to the goods remains in the seller until full performance by the purchaser of his part of the contract. In the event that the purchaser fails to pay installments of the price as they fall due, the seller has the right to repossess himself of the goods wherever he may find them, assuming, of course, that he has complied with the various statutory provisions regulating conditional sales. Reference to certain of these statutory provisions will be made at a later point in the discussion.

2. *Pretended bailments or leases.*—Occasionally a seller endeavors to avoid the statute relating to conditional sales by a contract which makes a pretense that it is only a contract of leasing of the goods to the buyer—whom the agreement designates as lessee—and provides that he is to pay a monthly "rental" for the goods for a specified period, the so-called "lessee" to become owner on the completion of the monthly "rental."

Such an attempt to disguise the true nature of the transaction and avoid the operation of the statute is ineffective and will fail. Where it appears that the so-called lessee is bound to make the "rental" payments for a specified period of time and that the total of the rental payments is substantially equal to the value of the goods, the courts, looking to the real intention of the parties, will hold the transaction to be a conditional sale.

The Uniform Conditional Sales Act enacts that a conditional sale is effected by:

. . . any contract for the bailment or leasing of goods by which the bailee or lessee contracts to pay as compensation a sum substantially equivalent to the value of the goods, and by which it is agreed that the bailee or lessee is bound to become, or has the option of becoming, the owner of such goods upon full compliance with the terms of the contract.

It is, of course, possible to have a bona-fide lease with an option to buy. To such a case the conditional sales act has no application.

3. *Distinction between conditional sale and chattel mortgage.*—In many states there are statutes controlling conditional sales and still others relating to chattel mortgages. Although both of these instruments are used to secure the payment of money, they are essentially different. The sole purpose of the conditional sale is to afford to the seller security for the payment of the price of the goods. In a sense the seller is a lender and the buyer a borrower, but the title and ownership which, before the conditional sale, was in the seller-lender continues in him and does not pass to the buyer until he pays the full price.

The situation in the case of the chattel mortgage is just the reverse. In a chattel mortgage, the ownership of the goods is in the borrower at the time the transaction is entered upon and he affects such ownership by the execution of the mortgage as security for the payment of the debt. Whether the mortgage is given effect according to its form as transferring the ownership of the goods to the mortgagee in security, or as merely subjecting the mortgaged goods

to a lien securing payment of the debt, the ownership of the goods remaining in the mortgagor, it is equally essential that the mortgagor be owner of the goods at the time of the execution of the mortgage. If he was not then owner, the mortgage could neither operate to transfer ownership of the goods nor subject them to a lien, as security.

In a conditional sale, possession of the goods, at least until default, goes to and stays with the buyer-borrower, and it is contemplated that he shall have the use of the goods; whereas, under a chattel mortgage, while the borrower ordinarily retains possession, not infrequently the goods are delivered at once into the possession of the chattel mortgagee.

4. *Statutory requirements for filing conditional sales contracts.*—It is a general principle of law that a person cannot be deprived of the ownership of goods without his consent, in the absence of conduct creating an estoppel against him. Merely giving another possession of goods, and no more, does raise an estoppel. Hence, in the absence of a statute, if one sells goods and delivers possession to the buyer but retains the title as security for the price—as in the case of a conditional sale—the seller can recover the goods from one who purchased from the defaulting buyer even though the second purchaser had no knowledge of the seller's ownership. In this situation, it is unsafe for anyone to purchase personal property from another, relying on the other's possession as evidence of ownership.

In the absence of a statute, the same danger exists where a chattel mortgage on goods is given to a lender, but the borrower remains in possession.

In earlier days the number of transactions of this sort was not sufficiently large to impress on our various lawmaking bodies the necessity of providing a remedy, but increasing frequency of use later made reform imperative. So statutes will now be found in most jurisdictions, requiring that chattel mortgages and conditional sales be filed or recorded, or both, in order to establish the mortgagee's or seller's prior claim as against purchasers or creditors of the mortgagor or conditional buyer.

The filing or recording of such documents in the manner provided by statute is deemed to give notice of the chattel mortgagee's or conditional seller's rights, as the case may be, to all who may subsequently deal with the property. The practical result is that one who is about to purchase personal property can go to the public records and make search to see whether or not the property which he purposes buying is affected by a chattel mortgage or conditional sale.

5. *Rights of subpurchasers from conditional sale buyers.*—Whether a person makes a search of the records or not, he will be deemed to have notice of the conditional seller's title and, hence, if he buys from the conditional vendee, he is not a purchaser without notice. He will be obliged to give up the goods to the conditional seller, if the first buyer de-

faults on his payments. The rights of creditors of the conditional buyer will be subordinate to the rights of the conditional seller only if the latter has properly filed or recorded the contract.

A conditional sale contract, which is not filed or recorded as required by the statutes, will be void and of no effect against any purchaser, mortgagee, or creditor of the buyer, who, without notice of the reservation of the title in the seller, purchases, takes a mortgage on, or attaches or levies upon the goods.

The provisions of the recording statutes, however, are without importance except in cases where the rights of third persons, not parties to the contract, are involved. As between the conditional seller and buyer, the contract of conditional sale is valid though it is not filed or recorded. So also a subsequent purchaser or mortgagee with actual knowledge of the reservation of title by the conditional seller cannot avail himself of the fact that the contract has not been filed or recorded.

6. *The buyer's interest is more than a mere contract right.*—Ordinarily, when an agreement between a seller and purchaser provides that title is to pass at a future time, some act on the seller's part, like appropriation, is necessary before title passes to the buyer. The seller may refuse to transfer the ownership or title and the buyer has no redress except a suit under the contract for damages. He cannot obtain the goods themselves. They are not his. Under a conditional sales agreement, no act on the part of

the seller is necessary to give title to the buyer when payments are completed. The buyer acquires from the agreement not only the possession and right to use the goods, but the right to become absolute owner upon complying with the terms of the contract, and this is a right of which the seller cannot divest him. The buyer, therefore, has the interest of a special owner which the law recognizes and protects. Cases have accordingly held that the buyer's interest in the goods may be assigned, mortgaged, or sold, unless there is some provision in the contract restraining him and that such an assignee, mortgagee, or vendee succeeds to the buyer's rights, i.e., the right to complete the payments and become owner of the goods. It is also held that the buyer's interest in the goods is subject to attachment by his creditors, an act which they make effective by completing the payments.

Any such third parties will, of course, take their rights subject to the seller's right to reclaim the goods, if the agreed payments are not made, provided the seller has duly filed or recorded the instrument.

In the ordinary contract to sell goods, if the buyer refuses to take title when the seller tenders it, the seller, save in exceptional instances, cannot force title on the buyer. He cannot recover the purchase price. He can only sue for damages for the breach of contract. In the case of a conditional sale, probably all courts would permit the seller to recover the full price if the buyer breaks the contract.

Thus it is, that, in the conditional sale, although the title remains with the seller for security purposes, the buyer also has incidents of ownership called, for want of a better term, a special or equitable ownership.

7. *The risk of loss.*—As appeared in the previous chapter dealing with the passing of title and the risk of loss, generally the risk of loss falls on the person who has title. But the Uniform Sales Act provides that, when the title to goods is held merely to secure performance by the buyer of his obligations under the contract, the goods are at the buyer's risk from the time of delivery to him. An example of the application of this rule appeared in the illustration previously given where the seller delivered goods to a carrier and took out a bill of lading, running to himself as consignee, merely to secure control over the goods until the price was paid or drafts accepted. The rule also applies to conditional sales, since in such cases the title is held by the seller merely for security. Hence, any loss falls upon the buyer after delivery to him, and, conversely, an increase in the goods belongs to the buyer. Apparently the only illustration of the last statement is that class of cases where young are born to an animal sold under a conditional sale. The buyer, upon paying the price, becomes the owner of the young, as well as of the mother.

The Uniform Conditional Sales Act specifically provides that "after the delivery of the goods to the

buyer and prior to the retaking of them by the seller, the risk of injury and loss shall rest upon the buyer." The increase of the goods is subject to the same conditions as the original goods.

8. *The Uniform Conditional Sales Act.*—The principles considered up to this point will be found to be true in every jurisdiction which has adopted filing or recording acts relating to conditional sales. Nine states, at the time of this writing, have adopted the Uniform Conditional Sales Act. Aside from those states, the provisions as to the method of filing and recording such transactions differ, as do the provisions relating to the seller's remedies in case the buyer is in default. Such provisions, however, are usually more or less the same as those contained in the uniform act. The reader should take care to acquaint himself with the laws of his own jurisdiction and follow them wherever he is required to deal with this class of transactions. We will now sketch the more important provisions of the statutes.

9. *Filing and refiling.*—The reservation of title by the seller who has delivered possession of goods to the buyer under a conditional sale is void, as against purchasers from, mortgagees, and judgment or attaching creditors of the buyer, as has been seen, unless the original agreement (in some jurisdictions a copy) is filed (sometimes recorded) in a specified public office, sometimes the office of the town clerk or of the county clerk, either where the buyer resides, or where the goods are kept for use by the buyer

after the sale. The filing should be effected immediately after the sale, the same day if possible, or certainly not later than the next succeeding day.

In some jurisdictions the signature must be acknowledged; in others this is not necessary. It is always advisable to secure an acknowledgment, since it affords proof of the signatures. Sometimes there is a requirement for an affidavit by the conditional seller stating the actual consideration for the transaction. There are also provisions for a refiling of these instruments before the lapse of a prescribed period which differs in the different jurisdictions. In New York, for example, there is a requirement for refiling during the 30-day period immediately preceding the expiration of a year from the date of first filing, in default of which the filing ceases to be operative.

After the buyer has fulfilled his obligations by paying in full, the Uniform Act provides that he, or any other person having an interest in the goods, may demand a written statement from the seller acknowledging that fact and that a note of the cancellation of the contract shall be made upon the page where the contract is filed or entered on the public record.

10. *Prohibition of removal without notice.*—The buyer may desire to remove the goods from the filing district to another. This he may do without the consent of the seller, but it is evident that third persons are likely to be defrauded, if the buyer makes a sale without disclosing to the sub-buyer that the title has

been reserved by the original seller. Prospective purchasers of goods naturally will examine the records of the city or county in which the goods are located. So the statutes usually provide that, if the buyer purposes to remove the goods from the filing district (except for temporary uses for a limited period such as 30 days), he shall first give the seller notice personally, or by registered mail, of the time of removal and the place to which they are to be removed, in default of which notice the seller may retake possession and deal with them as if the buyer defaulted in payment. Such a notice gives the seller an opportunity to refile or record the transaction in the new district. If he does not do so, the reservation of title will be void as against innocent purchasers for value from the conditional buyer.

It is also often provided that the buyer shall give notice to the seller of any sale, mortgage, or other disposition of his interest in the goods before the condition is performed.

A very potent section of the Uniform Act provides, further, that, if the buyer before payment "maliciously or with intent to defraud, shall injure, destroy, or conceal the goods, or remove them to a filing district where the contract or a copy thereof is not filed, without having given the notice required, or shall sell, mortgage, or otherwise dispose of such goods under claim of full ownership, he shall be guilty of a crime and upon conviction thereof shall be" imprisoned, or fined, or both.

11. *Seller's remedies upon buyer's default.*—The provisions regulating the manner of enforcing the seller's rights upon the buyer's default vary considerably under the statutes and are somewhat detailed and complicated. The main concern of the seller in such cases is to regain possession of the goods. If he can take them into his possession without a breach of the peace, he will not need to employ the machinery of the law for that purpose. Usually the buyer will peaceably surrender the goods upon demand. Often the chief difficulty the seller faces is to locate the goods. If the seller cannot retake without a breach of the peace, he will have to proceed as the law permits. It would only confuse the reader, rather than inform him, to attempt to set forth here in detail the legal remedies, such as replevin, and the requisite notices required. In such cases, it will be almost imperative to employ an attorney.

12. *Considerations in drafting installment contracts.*—The contract should be in writing and describe the goods, the price, and the terms of sale. Provisions should be made for interest, if any, to be charged on overdue payments; and, if a discount is to be given for cash or accelerated payments at any period during the life of the contract, it should be stated.

Although the risk of loss is on the buyer, if the goods are of any considerable value they should be covered by insurance, since, if the goods are destroyed, the seller will have to rely upon the buyer's

ability to pay the price. The seller ordinarily takes care of this himself and adds an additional charge to cover the insurance premium. If any number of installment sales are contemplated by a merchant, he should employ a competent attorney to draw a standard form of contract.

It is usual and desirable to provide in such contracts that, in case of default for some specified time, the entire unpaid balance shall become immediately due and payable. Otherwise the seller can collect only for the payments which are due at the time of suit, and he will have to repeat the process as future installments fall due.

13. *Sales in bulk.*—Although sales in bulk have no relation to the matter of conditional sales, it has been thought desirable to add a reference to the law on that subject at this point.

A species of commercial fraud that is sometimes perpetrated is when a debtor sells out his entire business without giving his creditors previous notice and departs with the proceeds. The stock of goods carried by a merchant usually is one of the important elements taken into consideration by those extending credit to him. The wholesalers and jobbers who sell to him on time would be seriously prejudiced, if he were permitted to dispose of his whole stock of goods in a way not in the usual course of business. For these reasons, remedial statutes, usually called bulk sales laws, have been quite commonly enacted in the several states.

14. *What constitutes a sale in bulk.*—In order to fall within the provisions of the bulk sales laws, the sale must be of all or of a substantial part of the stock of a retail dealer. The sale must also be made otherwise than in the regular course of business, for a dealer handling one line of goods might, in the ordinary course of business, sell the greater part of them in one transaction to a single buyer, and the deal might not necessarily fall within the prohibition of the bulk sales laws, provided it was the intention of the merchant to continue in business at the same stand, and have his stock replenished and ready for the next customer as rapidly as he could get goods delivered. The kind of sale provided against is one where the intent of the seller is to transfer all or the greater part of his goods and to go out of business.

15. *Conditions necessary to validate sale in bulk.*—Differing in details, the purport of bulk sales laws is as follows: Sales of this nature are held to be absolutely void or to raise a presumption of fraud, unless the buyer shall demand and actually receive from the seller a complete list of all of the seller's creditors, specifying the amount owed to each. This list is required to be attested by the oath of the seller that it is full, correct, and complete. After receiving this list of creditors, it becomes the duty of the buyer to give notice of the transaction to each of the creditors a prescribed time, usually at least five days, before taking possession of the goods. The notice must be given either personally or by registered letter, and

should advise the creditor of the fact of the sale and of the total amount of the purchase price, and the manner in which it is to be paid.

16. *Penalties for failure to comply with the statute.*—Again, while statutes in various jurisdictions differ as to details, generally if the provisions of the bulk sales law are not complied with, creditors may make application to the proper court, within a stipulated time, usually 90 days, to have the buyer held as a trustee on behalf of the creditor or creditors. Or, in some instances, a receiver may be appointed. The creditor's debt is then met by a sale of the goods and an application of the proceeds to his claim, only so much of the goods being sold as is necessary for that purpose. It is vital that the creditor's application be brought within the prescribed time.

REVIEW

Define "conditional sale."

Outline the filing requirements.

What rights has a buyer under a conditional sale?

State some of the practical considerations in drafting installment contracts.

Explain the incidents of sales in bulk.

CHAPTER XIII

COMMON CARRIERS

1. *Definition.*—A common carrier is a person or corporation whose regular business it is to transport goods for hire, for all persons who choose to employ him. He makes of his business a public calling and holds himself out as ready to exercise it. Because of the public nature of his occupation, he is bound to receive and convey all goods offered for transportation under conditions fixed by public notice, unless there is a legally sufficient cause for refusal, and he may not discriminate unjustly between his customers, either in charges or in service.

A private carrier, on the other hand, is privileged to do business with whomsoever he pleases and upon whatever conditions he pleases.

Operators of railways, ships, ferries, barges, and lines of motor trucks, who offer their services as ready to transport goods from place to place as called upon by the public, are common carriers. The proprietor of a one-truck delivery service, however, who reserves the right to deal with whomsoever he pleases, is a private carrier, as also is anyone who undertakes the transportation of goods only incidentally, in special cases, or for particular customers.

The obligations of the private carrier will be fixed by each contract that he makes and by the general law of bailments.

The obligations of the common carrier, however, are governed by special rules of the common law and by a multitude of federal and state statutes. The activities of the common carrier are also more or less closely controlled by regulating bodies. Interstate common carriers, for example, are supervised and regulated by the United States Interstate Commerce Commission; intrastate common carriers are controlled by state public service commissions.

2. *Basis of common carrier's legal status.*—The historical basis of the common carrier's special liability as an insurer of the goods he carries is thought to be found in the dangers of the road that existed in the old stagecoach days in England. These vehicles went through woods or near woods in which robbers abounded. The coaches were robbed so frequently that, to protect themselves, it is supposed that the coach drivers entered into league with the robbers and divided their spoils. So the law required the coaches to travel only in the day time, with armed guards, and the carriers were made insurers of the goods they carried. So, too, the requirement that innkeepers receive guests who present themselves, ready to pay for accommodation, is supposed to have originated in the fact that the roads were infested with robbers and thus it was necessary that at night time travelers be afforded a haven.

However this may be, the common carriers' liabilities are based upon good reasons today. They are public servants exercising a public calling. Their lines are the arteries through which commerce flows. They are given franchises, privileges, and immunities not granted to ordinary business enterprises. In return for these things, they are held to the observance of rules differing somewhat from those applicable to ordinary bailees.

3. *Their liabilities.*—We have already noted that common carriers are obliged to transport the goods of anyone who desires such service, if he is ready to pay. They may be sued, if, without proper justification, they refuse to carry the goods. They are bound to take proper care of the goods which they undertake to transport, and to make a safe and proper delivery. The ordinary bailee may excuse failure to carry out his contract by showing that he was prevented from doing so by some cause not the result of his own negligence or that of his agents. The common carrier's liability is greater. He not merely *promises* delivery, but, with certain exceptions, he is held to have *insured* delivery by accepting goods for transportation. Hence, if his failure to make delivery is not due to any of the exceptional causes next to be discussed, the carrier is responsible for any loss or damage to the goods even though the loss or damage is not attributable to his fault.

4. *Exceptions: "Acts of God."*—When loss or damage to goods in the hands of a carrier is caused

by an earthquake; by great storms or great floods; by lightning; or by like natural catastrophes without the interposition of human agency, the carrier is excused. Such an event, for want of a better term, is called an "Act of God." To excuse the carrier, the happening must have been one of such an unusual nature that reasonable prudence and foresight could not have guarded against it. Most train wrecks are not caused by "Acts of God," but are due to human negligence or carelessness, and doubtless most fires are caused by some human agency.

Where the loss is due to an "Act of God," the carrier is bound to do everything reasonable to diminish the loss. Some cases also hold that the carrier is liable, if there has been a combination of unreasonable delay in transit and an "Act of God"; others hold that the delay does not deprive him of the benefit of the exception.

5. *Exceptions: Act of the public enemy or of the public authority.*—Another exception to the carrier's liability as insurer is to be found when the loss or damage is caused by the armed forces of a country at war with the country of the carrier's origin or by an armed force in rebellion. Although pirates have been classed with the "public enemy," train robbers and thieves are not. The carrier is also excused if the goods are seized by a duly authorized officer acting under a process of law that is regular and valid upon its face. An example would be where goods are seized and destroyed by health authorities.

6. *Negligence of the shipper.*—The carrier has a right to insist that goods offered for transportation shall be properly packed. If the loss is due to improper packing, it is primarily the fault of the shipper and the carrier will be excused. So, also, the shipper must correctly describe the goods. Thus, if the goods are of a class that requires especially careful handling, they must be so described and marked. Likewise, the shipper must not disguise the value of the goods, as by doing so the carrier may be induced to give less care and attention to their transportation than might otherwise have been given. For example, if a shipper packed diamonds in a box of straw and shipped the box as crockery, the carrier would not be responsible, since he was entitled to know what the box contained in order that he might take proper precautions for its protection.

7. *Loss due to the inherent nature of the goods.*—The final exception to the carrier's liability as insurer is found when the loss is due to the inherent nature of the goods. An example would be a shipment of perishable goods, such as fruit, when the loss resulted from their natural deterioration without negligence on the carrier's part. The carrier is bound, of course, if the nature of the goods is made known to him, to provide suitable means of transportation and to exercise that degree of care which the nature of the property requires.

In summary, then, we note five grounds upon which the carrier may be released from his liability

as insurer, namely, when the loss or damage is due to:

(a) An Act of God
(b) An act of the public enemy
(c) An act of the public authority
(d) The shipper's negligence
(e) The inherent nature of the goods

8. *Liability of carrier for delay.*—Although the law imposes a liability as insurer upon a common carrier, he is not made an insurer against delay. If his published tariffs permit, he may enter into a special contract with the shipper by which he agrees to insure delivery upon a certain date and, if he defaults, he will be liable, upon ordinary contract principles. But, in the absense of a special contract, he is required to use merely reasonable diligence and care to convey the shipment within the customary or reasonable time. Only negligence will render him liable for delay beyond that time. The carrier, furthermore, is not bound to carry by the shortest route, if that be not the ordinary route.

It should also be observed that, although the carrier must accept and convey the goods of any shipper without discrimination, because of the public nature of his business, he is not held to any liability, if, due to sudden and great demands which he had no reason to apprehend, his facilities have been taxed to the very utmost so that he is unable to furnish cars. The carrier is expected to have at all times ample facilities for handling goods offered, but he is entitled to refuse goods which he cannot properly handle due

to an emergency. The reader will recall occasions, for example, when the carriers have imposed embargoes for limited periods on the further shipment of goods to certain points, when strikes of truckmen have caused the terminal yards to be jammed with cars which could not be unloaded.

9. *Modification of liability by agreement.*—The rules stated in preceding sections relating to the carrier's liability are those which are imposed by the general law in the absence of statutes or contractual agreements to the contrary. The power to regulate interstate and foreign commerce is granted by the Constitution to Congress. Accordingly, Congress has enacted a statute known as the Act to Regulate Commerce. This act requires common carriers to furnish transportation service and facilities to the public at a cost and under terms and conditions which shall be fair and reasonable. The carriers are likewise required to publish and file in Washington, and to keep open for public inspection at their stations and elsewhere, tariffs which set forth the rates, rules, and regulations under which the transportation service will be performed. Among the provisions of such tariffs is the form of the bill of lading contract between the shipper and the carrier which governs the transportation of each shipment. The publication of these tariffs constitutes, under the act, binding notice of their contents to shippers, and the act further provides that no contract of transportation is lawful which is at variance with the rates, rules, regulations,

and contract provisions that are stated in the tariffs.

Because in law, shippers are deemed to have notice of such provisions, the contract of transportation arises when the shipper delivers goods to the carrier for conveyance, and the provisions of the published tariffs and regulations are binding parts of the contract, whether actually shown to the shipper or not, and whether or not the bill of lading is actually signed by the parties. It is the universal practice, however, to have the bill of lading actually issued and signed.

10. *The bill of lading.*—The bill of lading is both a receipt for the goods and the contract for carriage. As was seen in the chapter dealing with the passing of title in the sale of goods, the negotiable bill of lading is also a document of title by means of which a seller may control the goods until he is paid.

At this point we are concerned with the bill of lading only as a receipt for the goods and as the contract of carriage, and not with its effect as between a seller and a buyer.

11. *Two kinds of bills of lading.*—There are two standard forms of bills of lading in general use—the "order bill" and the "straight bill." The order bill of lading states that the goods are consigned "to the order of" any person named in such bill. It is a negotiable instrument and may be transferred by indorsement and delivery. Since such a bill may be negotiated through several hands, the last indorsee named therein being entitled to the goods, the carrier

must not surrender the goods to any person unless the bill of lading is given up to be canceled, and then only to the person to whose order the goods are consigned; or, if there have been one or more indorsements, then to the indorsee last named upon the bill. If the carrier makes a misdelivery to one not entitled to the possession of the goods, he is liable in damages to the one who has the right of property or possession by the terms of the bill. A seller, however, may stop goods in transitu upon the insolvency of the buyer even though they were shipped under an order bill, provided the buyer to whose order the goods were consigned has not indorsed the bill to a bona fide purchaser for value. As between the buyer and the seller, the seller will be entitled to the goods, after he has lawfully stopped them in transitu.

The straight bill of lading is one in which it is stated that the goods are consigned to a specified person, without any order words. It is not negotiable and it is not necessary therefore that the carrier, to protect himself, demand its surrender. Unless the goods have been stopped in transitu, the carrier must deliver them to the consignee named in the bill.

Under either a straight or order bill of lading, the carrier is entitled to hold the goods until his lien for the freight charges is discharged, and he may exercise this right against a seller who has given notice to stop in transitu, as well as against the consignee named in the straight bill or the holder of a negotiable bill.

12. *Extent to which liability may be modified.*— The bill of lading, in either form, is presumed to contain all the terms of the contract of carriage. As with other written instruments, oral evidence cannot be introduced to vary its terms or to contradict them. Thus, a verbal statement of a local freight agent could not be availed of by the shipper to defeat a contrary provision of the bill of lading.

The parties, however, may desire to make different terms than those provided in the standard form, and this can be done in writing within certain limits. The common law liability of the carrier may be limited or qualified by a special contract, if the limitation or qualification is just and reasonable; and it does not exempt the carrier from responsibility for loss or damage due to negligence. It is considered to be against public policy to permit the carrier, even by special agreement in consideration of a reduced rate of transportation, to discharge altogether its liability for loss or damage to goods arising from its own negligence. The weight of authority does admit, however, that valid contracts, if supported by a consideration, such as a reduced rate, may be made, providing that the carrier's liability for loss or damage shall not exceed an agreed value, whether the loss or injury is due to its own negligence or otherwise. Such a stipulation would not apply, however, in case the carrier converted the goods, or in case he failed to obey the shipper's order to stop the goods in transitu. The shipper is not bound to avail himself of

the lower rate by accepting the value fixed by the carrier, but may secure a greater liability (not, of course, to exceed the value of the goods) by paying a higher rate.

In a few states, there are statutes affecting shipments from point to point within the state, which prohibit carriers from limiting in any wise their common law liability.

A carrier may stipulate in the contract that its liability shall only be that of a warehouseman, if the goods are not removed from the car or freight house within a prescribed time after arrival at their destination.

13. *Connecting carriers.*—Shipments often pass over the lines of several connecting carriers and, if a loss occurs, the question arises as to which carrier is responsible. The majority rule is that the liability of the initial carrier ends when it delivers the goods to a connecting carrier, in the absence of any agreement in the contract to the contary, or of any partnership agreement between the connecting carriers or joint contract for transportation.

If the carrier gives a through bill of lading to a point to which delivery must be effected through a connecting carrier, most states construe this as a contract whereby the initial carrier makes itself liable for loss occurring at any point in the transportation.

The effect of the above rules has been changed, however, so far as interstate shipments are concerned, by an act of Congress known as the Carmack amend-

ment. Under this statute, the initial carrier who accepts goods for shipment to a point on another line in a different state is liable to the shipper for loss or injury occurring anywhere along the journey. The initial carrier, in turn, will have a right of action against any connecting carrier upon whose line the loss may have occurred.

14. *When the carrier's liability begins.*—The responsibility of the carrier, as of any bailee, begins when the goods have been delivered to it, duly marked and consigned and accepted by it for transportation. As to the place of delivery, usage will control. Usually goods in less than carload lots must be delivered to that part of the station designated for the receipt of freight shipments. Shipments in carload lots must be loaded by the shipper into cars either on his private siding or on the public team track of the carrier at the station, and thereafter delivered with shipping instructions to the carrier.

The liability of the carrier does not attach, until the goods have actually passed into its control. The mere deposit of goods upon a platform does not put them within the carrier's control. Such control arises, when the local agent has taken charge of the goods.

15. *When the carrier's liability terminates.*—The carrier's liability terminates when he has delivered the goods, or when there is some good excuse for non-delivery. Generally speaking, so long as the goods remain on the carrier's premises, delivery is not considered made, even though negotiations for

the removal of the goods have been entered into. Even though the goods have been unloaded and stored in the carrier's warehouse, his liability continues until he has given the consignee notice and a reasonable time in which to remove. If the consignee delays more than a reasonable time in removing the goods, the carrier's liability is then reduced to that of a warehouseman. This is also the rule, when the consignee requests the carrier to continue to store for a time for his convenience.

If the consignee is to do the unloading, it has been generally held that the transportation is not ended until the car is placed on a track convenient for the purpose.

16. *When failure to deliver is excused.*—If goods are to be delivered at the consignee's address, and they are refused at that address, the liability as a carrier ceases. It must then take reasonable care of the goods as an ordinary bailee, but its extraordinary liability as carrier ceases.

The carrier is excused from making delivery, if the goods have been lawfully stopped in transitu by the seller, or if they have been attached by process of law.

Furthermore, the carrier may refuse to make delivery to the consignee, or to a seller who has lawfully stopped the goods, or even to an attaching officer, until the freight charges have been paid, together with any additional charges for storage or demurrage which may have accrued. The carrier has a lien upon

the goods for these charges, just as ordinary bailees have a lien upon goods which they have stored or done work upon, and this lien is superior to the rights of any other person.

17. *Ordinary bailments.*—In the course of this chapter, we have several times referred to the term "bailee," and have said that under some circumstances the extraordinary liability of a carrier may be reduced to that of an ordinary bailee. A few words may now be added as to the law of bailments, generally.

A bailment is a transfer of possession of goods for some particular purpose to a person other than the owner. Thus, a carrier is a special kind of a bailee to whom possession has been given for the purpose of transportation; a warehouseman is a bailee to whom possession is transferred for the purpose of storage; a garageman is a bailee to whom possession is transferred for safekeeping or for repairs, or both; goods are deposited with a pawnbroker as bailee for the purpose of giving security for a loan. Many other types of bailments will occur to the reader where the ownership is in one person and the possession is in another for some purpose.

18. *Duties of the bailee.*—The bailee must carry out the owner's instructions and must exercise reasonable care to safeguard the goods intrusted to him. If he is to perform work upon them, the bailee is bound to employ a degree of skill commensurate with the nature of his business and which, by reason of

being engaged in that business, he holds himself out to the public to possess. The degree of care that will be held to be reasonable will depend upon the nature of the bailment and the circumstances of the case.

A bailment to care for goods without compensation to the bailee, or a bailment for the use of the goods by the bailee without compensation to the bailor, is a gratuitous bailment. In either case no contract exists, because of the absence of consideration. The duty to use reasonable care in these cases is simply an application of the law of negligence. If the bailee fails to use the care that an average man would use under the circumstances, he is guilty of negligence, and liable for the damages resulting from such wrong or tort.

It is said that a gratuitous bailee in the first class of cases is liable only for gross negligence. This means that he is not held to as high a standard of care as would be required of him if he were receiving pay for holding the goods. It is said that he is liable for slight negligence, if he is getting the beneficial use of the particular property for nothing.

19. *Bailments not gratuitous.*—If the bailment is not gratuitous, there is a valid consideration and a contract exists. The ordinary standard of care, reasonable care under the circumstances, then applies. If such a bailee uses the property in a way not authorized by the contract of bailment, and the property is damaged or destroyed, whether because of

such authorized use or not, he is liable for the loss. Though this is called conversion, a term used in law to designate assuming control for one's own use of the property of another, it is not legally conversion unless an intent to convert, in destruction of the property right of the bailor, is made out.

This is seldom the case. The law simply holds the bailee liable for any damage to the property, happening during the diversion to unauthorized uses, without regard as to whether the diversion caused the damage or not. For instance, if a man hires a horse to go to town A and he drives the horse beyond town A to town B, the bailee becomes absolutely liable, if the horse dies during such diversion from the original agreement, though he die of some disease with which the driving to town B could have had no connection.

20. *Pledges.*—A pledge is the delivery of personal property to a creditor to secure payment of a debt or performance of any contractual obligation in favor of the creditor, or pledgee. Bonds or other obligations under seal and negotiable instruments may be pledged by transfer of possession. Choses or rights of action represented by documents, such as insurance policies and stock certificates, may be pledged in the same way. Though other rights of action may be assigned by way of security, such transactions are not pledges because there is no transfer of physical possession.

Payment of the debt, of course, discharges the pledge. Tender of payment, not accepted by the

pledgee, also discharges the lien, so that the pledgor may then recover possession of the property pledged. A man cannot retain his security for a debt after rejecting a valid tender of the amount due. Tender is usually made on condition that the pledge be returned, and is valid when so made. The debt may be enforced by action, however, without enforcing the pledge or tendering back the pledged property.

The pledgee may sell the pledged property after default of the debtor, on reasonable notice to him, or by foreclosure of the lien in equity. Statutes in many states regulate the enforcement of pledges. The pledgee's right, apart from statute, is an implied power of sale reasonably incident to the pledge. Either party may assign or transfer to another his property interest in the thing pledged, subject to the rights of the other party.

21. *Storage or warehouse bailments.*—When property is placed in storage, the duty of the owner is to pay the price of storage agreed upon or its reasonable value as the case may be. The duty of a warehouseman is to use reasonable care under the circumstances, and he impliedly represents and warrants that he has the skill of the average person qualified to perform the particular contract of storage involved.

The law of warehousemen has been codified in a uniform statute enacted in a majority of the states. It provides that warehouse receipts which make the goods deliverable *to order* or *to bearer* are negotiable,

and that a provision in such a receipt that it shall be non-negotiable is void. If the receipt is non-negotiable, the act provides that the words "non-negotiable" shall be placed plainly on its face, otherwise, one taking it and believing it to be negotiable will have the right, at his option, to enforce it as such.

The rights and duties of the parties are provided for in detail by the statute, and apply, as in usual cases of bailment, requirements of due care, duty to deliver to the owner, etc. These are modified necessarily by the provisions making receipts negotiable, when payable *to order* or *to bearer*. The act also provides a warehouseman's lien for his charges and its enforcement, giving him relief from the common law which does not recognize such a lien.

REVIEW

Distinguish between a common carrier and a private carrier.

Explain the common carrier's liability as insurer and the exceptions thereto.

State to what extent a common carrier may limit its liability on a contract with a shipper.

When does the carrier's liability begin? When does it end?

Define a bailment and state the duties of ordinary bailees.

CHAPTER XIV

NEGOTIABLE INSTRUMENTS

1. *Origin of negotiable instruments.*—Negotiable instruments include promissory notes, bills of exchange, and checks. There are other instruments which have some of the qualities of such commercial paper, and are sometimes described as quasi-negotiable instruments. Bills of lading, certificates of deposit, warehouse receipts, stock certificates, coupons, and letters of credit are examples of this type.

The law of negotiable instruments originally grew up as a custom among the merchants in medieval times. Because of its convenience in the transaction of business, this custom finally came to have the force of law, its rules were enforced by the courts, and finally crystallized into a statute adopted by the English Parliament in 1705. This statute served as a basis of the American law upon the subject until the Uniform Negotiable Instruments Law was formulated. In the last twenty-five years, this uniform law has been enacted by most of the states.

2. *Negotiability.*—Negotiable paper is of great convenience to the business man. The quality of negotiability enables the owner of the instrument to transfer to another, under conditions hereinafter con-

sidered, a better title to it than the original owner possessed.

When one of the parties to an ordinary contract assigns his rights under the contract, the assignee is in legal effect substituted in place of the original party. Any defense or counterclaim that would have been available to the other contracting party, against the assignor of the contract, is equally available against the assignee. Thus, the rights and obligations of the assignee of a contract become impossible of determination without full inquiry as to the rights and obligations existing between the original parties to the contract.

The quality of negotiability, however, enables the holder of a promissory note, or bill of exchange, to transfer the title of the instrument to another person free from defenses, setoffs, and counterclaims which existed between the original parties. In consequence, the party under obligation to pay is compelled to pay in exact accordance with the terms of the instrument, regardless of any claim that he may have against the original payee of the instrument.

For example, if Brown buys goods from Sharp which Sharp warrants to possess certain qualities, and Brown gives Sharp a negotiable note in payment, and later Brown discovers that Sharp's warranty as to quality was false and fraudulent, Sharp's fraud may be used by Brown as a complete defense to a suit on the note brought by Sharp.

But, if, instead of holding the note until it becomes

due, Sharp discounts it at his bank or transfers it in the usual course of business to Smith, who is ignorant of the fraud by which Sharp procured the note, the bank, or Smith, can compel Brown to pay the note in full, notwithstanding the fraud. Furthermore, when a negotiable instrument is transferred, the transfer is effectual against the maker, and full title passes to the transferee without notice to the maker. Therefore, if the maker pays the note before maturity to the prior holder, without obtaining the surrender of the instrument, and in ignorance of the fact that the instrument has previously been transferred, he will be compelled to pay it over again to the present holder. The obligor in a negotiable instrument, therefore, is entitled to, and should insist upon, the surrender of the instrument at the time he pays it.

The situation of an obligor under a negotiable instrument differs radically from that of an ordinary contract debtor who pays his creditor a debt that the latter has assigned without notice to the debtor. Payment to the creditor, in such case, without knowledge on the debtor's part that the claim has been assigned, is a complete defense to any action brought by the assignee.

3. *Negotiability of a promissory note.*—A promissory note, or bill of exchange, may or may not be negotiable. Whether it is negotiable or not can always be ascertained by inspection of the instrument. To be negotiable, the instrument must contain words

of negotiability. If, in the above case, Brown had made his note payable simply to John Sharp, the note would not have been negotiable, but, if he had made the note payable to "John Sharp or order," or the note had read "I promise to pay to the order of John Sharp," or had read "I promise to pay to bearer," the note would have been negotiable. Thus the words, "to order," or "to bearer," are words of negotiability, and determine the negotiable quality of the instrument.

What has been said as to negotiability applies equally to bills of exchange and promissory notes. These two instruments have many other qualities in common which will now be considered, but, for the sake of clearness, it will be necessary for us to make sure that the meanings of certain more or less technical terms connected with these instruments are understood.

4. *Form of negotiable instruments.*—The following is the usual form of a promissory note:

$1,000.00 New York, June 1, 19....

Sixty days after date I promise to pay John Sharp or order one thousand dollars.
Value received. Wm. Brown.

The person who signs the note, Wm. Brown, is the maker. The person to whom the note is payable, John Sharp, is the payee, and, while the note remains

in his hands, he is also the owner and holder. If Sharp indorses the note and delivers it to Ray Smith, Sharp will become an indorser and Smith will become the owner and holder.

The following is the usual form of a bill of exchange:

$1,000.00 Montreal, Canada, June 1, 19....

At sight pay to the order of Thomas Jones One thousand dollars .....
Value received and charge to account of
Richard Fox
To Import Hat Company, New York, N. Y.

The person who signs the bill of exchange, Richard Fox, is the drawer; the person or corporation ordered to pay, the Import Hat Company, is the drawee, and the person to whom payment is to be made, Thomas Jones, is the payee. If the payee indorses the instrument to Albert Hoe, and delivers it to him, the payee will then be known as an indorser, and Hoe is described variously as the indorsee, owner or holder.

Business usage has sanctioned certain definite forms for notes, drafts, and other instruments, and it is the part of wisdom for men in business to insist that all instruments follow the customary forms. It is important, however, that the business man should know his rights under irregular instruments, when, through the ignorance of his customers, or the negligence of his employees, they come into his possession.

5. *Formal requisites of negotiable instruments.*—An instrument to be negotiable must conform to the following requirements:

(a) It must be in writing, and signed by the maker or drawer.
(b) It must contain an unconditional promise, or order, to pay a certain sum of money.
(c) It must be payable on demand, or at a fixed or determinable future time.
(d) It must be payable to order, or to bearer.
(e) Where an instrument is addressed to a drawee he must be named, or otherwise indicated therein, with reasonable certainty.

As these requirements are of the greatest importance, we shall have to consider them somewhat in detail.

6. *Instrument must be written and signed by maker.*—A written statement, signed by the maker, to the effect that a certain amount is due a person named, implies that the sum named is due to the payee from the maker. It is an acknowledgment of indebtedness that implies a promise to pay the indebtedness on demand. Such an instrument is a promissory note. In a few states an instrument in the following form, "I. O. U. one hundred dollars," has been decided to be a promissory note payable on demand; but, in other states, the courts have held that such an instrument is a mere acknowledgment of indebtedness, and creates no new obligation to pay.

Should the instrument, however, read "I. O. U. or bearer one hundred dollars," or, "Due John Mason

or order one hundred dollars," or, "Due John Allen ninety-four dollars on demand," the instrument in each case would be treated as a promissory note despite its informal character. The law would imply from the words, "or bearer," "or order," or "on demand," a promise to pay.

The advantage to the creditor of obtaining a new obligation from the debtor can be shown by considering the case of a coal dealer who, at various times throughout the winter, delivers coal to a customer upon an order received by telephone and who, during the following summer, finds it necessary to sue the customer for the purchase price. In order to prove his case, it is necessary for the dealer to prove the actual delivery of each load of coal. His drivers may not be able to testify as to these particular deliveries. The defendant's employee who received the coal might have a still shorter memory. If receipts were taken by the driver, it would be necessary to prove the genuineness of the signature on each receipt, and that it was the signature either of the customer or of an employee authorized to sign. The dealer might lose the case because of the difficulty of proving delivery.

If, on the other hand, the dealer had obtained from his customer a promissory note for the amount due, and it then became necessary to sue the customer, the coal dealer would sue, not upon his original claim for the coal, but upon the promissory note. In that action it would be necessary for the coal dealer only

to produce the note and prove that the signature of the maker was that of the defendant.

7. *Conditional promises.*—To be negotiable, the instrument must contain a promise or order which is absolute and not conditional. Thus, a promise or any order to pay "subject to," "on condition that," or "if a named event happens," as "if A delivers deed as per contract," would obviously be a conditional promise or order and non-negotiable. Also, a promise or order to pay out of a specified fund is conditional, the condition being that there be that amount of money in the named fund. Whether there is, in fact, the amount in the fund is immaterial, for the question of negotiability is one to be determined solely from the face of the instrument.

8. *Certainty as to amount.*—The note must be a promise to pay a fixed sum of money that is legal tender at the place where the note is given. A promise to pay a fixed amount in foreign money, or in bonds, or in wheat, although, if supported by consideration, it would bind the maker to the fulfillment of the promise, would not constitute the special form of contract known as a negotiable instrument.

It is possible, however, without violation of the rule as to uncertainty, to provide that the amount shall be payable in specified installments at specified dates, and the note may also provide that, upon failure of the maker to pay any installment, the holder of the note shall have the option of declaring the entire amount due and payable at once.

9. *Time must be fixed or determinable.*—It is essential to negotiability that the question of whether the time for payment has arrived shall be determinable from a mere reading of the instrument, without resorting to an extrinsic source to ascertain whether or not some condition has been fulfilled. For instance, a promise to pay "one year after date if I am then living," or "30 days after the ship Franconia arrives at New York," is a conditional promise. The holder of such a promise could not decide merely by reading the instrument whether or not the time for payment had arrived. Such an instrument might be a valid contract, but it would not be a negotiable promissory note. If the time of payment fixed by the instrument is certain to arrive, although the precise time may be uncertain, the requirement as to definiteness of time is sufficiently met. An example of this is an order or promise to pay a certain sum of money "60 days after my death." Since the maker is certain to die, the requirement of the law of negotiability is fulfilled.

If a note fixes no specific time for payment, or if it expressly states that the maker will pay a fixed sum "on demand," it is called a demand note, and the holder may demand payment from the maker even on the same day the note is given, or at any time before the Statute of Limitations has run against it —in most states, six years. But, in order to hold an *indorser* liable upon such a note, payment must be demanded within a reasonable time. In determining

what is a reasonable time, the usage of trade or business with respect to such instruments, and the facts of the particular case must all be considered.

10. *Parties must be identified.*—The requirement regarding the use of "or order," "or bearer," has been discussed under the head of negotiability and need not be elaborated here. Not only the drawee, but all parties to the instrument must be designated with sufficient certainty for their identification. The name or signature which a person customarily uses may be employed to identify him as a party to such an instrument. For instance, William Brown may sign with a mark, or merely by his initials, and, if he conducts a store under the trade name, "Lucile," he may be designated by that name without impairing the legal effect of the instrument.

Generally speaking, the entire omission of any of the above elements of such an instrument, as, for example, the amount to be paid, the promise to pay, or the person by whom or to whom the money is to be paid, renders the instrument a nullity.

Bills and notes are sometimes intentionally made payable to the order of a purely fictitious payee or non-existing person, as "to cash." Such instruments are treated as payable to bearer, and title passes by mere delivery of the instrument without indorsement.

11. *Collateral notes.*—A negotiable note may contain a statement that collateral security has been given by the maker, specifying the property or

securities, and authorizing their sale in case the instrument is not paid at maturity. It may contain a clause authorizing the maker to sell the collateral, and regulating the manner of selling if the note is not paid at maturity. It may contain a promise to pay the costs of collection and the attorney's fees.

12. *Omissions and blanks.*—Sometimes a note, check, or bill of exchange is delivered by the maker in an incomplete form, with one or more spaces left for the insertion of an important part of the instrument. In such a case, the holder has authority to fill the blank in accordance with the understanding of the parties; if he fills it for a different amount or contrary to the agreement, he cannot enforce it against the maker. But, if he then indorses and delivers it for value in the usual course of business to a third person who has no knowledge of the agreement under which the holder received it, the third person can enforce it against the maker. Such cases are governed by a fundamental rule of law, of general application, to the effect that, if one of two persons, both of whom are innocent of any wrong, must suffer through the fraud of another, the loss should fall upon him whose negligence, or misplaced confidence in the honesty of the wrongdoer, has given the wrongdoer his opportunity. It is, therefore, highly dangerous for a maker to deliver an instrument with such blanks.

It should be observed, however, that if our friend, Brown, should write his name on a blank paper, as a

specimen of his signature, and give it to Crook, and the latter should write a note or a check over the signature and transfer it to Green for cash, Green could not enforce it against Brown, although he took it without knowledge of the fraud of Crook, for in that case Brown never intended to intrust Crook with a negotiable instrument, even an incomplete one.

Sometimes a man engaged in business prepares an incomplete negotiable instrument, and places it in his safe ready for use at a subsequent time. In such a case, if an employee steals the instrument, fills in the amount and negotiates it, even the bona fide holder will not be able to enforce the instrument against the maker, for the instrument was never *delivered* by the maker, and leaving it in his safe in incomplete form is not regarded as an act of negligence. But, if he leaves it in his desk or office, and it is stolen, filled out, and transferred to a good-faith purchaser, his negligence estops him from setting up the defense of non-delivery, in a subsequent suit on the instrument. Further, as to a check signed in blank, even where the drawer uses all possible care in the custody of the instrument, as, for example, locking it in his safe, if, notwithstanding such care, the instrument is stolen and paid at the bank upon which it is drawn, his account may be charged, and he is estopped by his negligence from denying delivery. It, therefore, appears that a higher degree of care is required in protection of the drawee bank than of the ordinary purchaser.

13. *Interest.*—A note, or bill, does not bear interest unless it so states, but, if a note by its terms is payable "with interest," or "with use," it bears interest at the highest legal rate in the state where it purports to have been made, i.e., the place named in the date of the note. For example, a note which is dated, New York, May 1, 1930, purports to have been made in New York, on that date.

When a non-interest bearing note is payable on demand, legal interest starts at the time payment is demanded. When a non-interest bearing note is payable at a fixed date, interest at the legal rate begins to run upon the note after the date upon which it is payable.

14. *Consideration.*—Like any other contract, a promissory note requires consideration. Lack of consideration is always a good defense to the maker in a suit by the payee. Any consideration which will support an ordinary contract will support the making or transfer of a bill or note. What constitutes a sufficient consideration for a contract has been explained in a previous chapter.

But, if the note is negotiable, it differs from other contracts in that it is implied without proof that it was issued for a valuable consideration, and every person whose signature appears upon the note is deemed to have become a party thereto for value. Therefore, the fact that the note was made or transferred without consideration is no defense to an action brought by a subsequent holder of the note

who, in the usual course of business, has given value therefor, in ignorance of the fact that the note was originally issued without consideration. Such person is usually described as a bona fide holder, or a holder in due course.

The words "value received," when appearing in a note or bill, are simply an acknowledgment that a consideration has been received by the maker or drawer. But the instrument itself implies that a consideration has been given, and the presence of the words "value received" does not prevent the maker or drawer from proving that there was, in fact, no consideration for the instrument. Therefore, the phrase is without effect.

15. *Nature of bills of exchange.*—The bill of exchange is better known to business men in the United States as a draft. The form of the bill of exchange has already been given. Instead of promising to pay another a certain sum, as the maker does in case of a promissory note, the drawer of a bill of exchange signs an unconditional order in writing addressed to another person requiring that person to pay, either on demand or at a fixed or determinable future time, a definite sum of money. The payment may be directed to be made either to the person who draws the bill or to some third person. Like a promissory note, if it is made payable to a person or corporation by name merely, it is not negotiable, but, if it is made payable to the order of such a person or corporation, or to bearer, it is negotiable.

If both drawer and drawee reside in the same state, the instrument is called an "inland" or "domestic" bill of exchange, but, if the drawer and drawee reside in different states or countries, it is called a "foreign bill."

The requisites of a promissory note—as to certainty of amount and time of payment, as to payment in money, and as to absolute terms of the promise, which have been discussed—apply equally to bills of exchange.

16. *Nature of a check.*—A check is a sight draft drawn on a bank. Of all the negotiable instruments, a check is probably the most familiar. It is essential to a check that its amount be payable on demand. If the instrument is payable on a day subsequent to its date, it is not a check but a bill of exchange. The Uniform Negotiable Instruments Law provides that the rules applicable to a bill of exchange payable on demand are applicable to a check with the exception of the provisions as to presentment, acceptance, and assignment.

In common with other bills of exchange, a check must contain an order to pay on demand a definite sum of money. It may or may not contain words of negotiability, but it must be presented to the bank for payment. A check may be indorsed in the same way as other negotiable instruments; it is not an assignment of the money of the depositor in the hands of the bank.

The principal points in which a check differs from

other bills of exchange are that a check is always drawn on a bank or banker; it is always payable on demand; it must be drawn on funds actually in the bank; the death of the drawer of a check revokes it and renders it worthless even in the hands of a holder in due course, while the death of a party has no such effect on a bill. A check, in a sense, is always overdue, and, hence, a person who takes it subsequent to its date is not charged with notice that the check may have been paid or dishonored as in the case of a bill of exchange. Moreover, the drawer of a check, unlike the drawer of a bill of exchange, is not relieved from liability because of delay in presenting the check for payment, unless he can show that he has been damaged by the delay. Some of these points will be considered in more detail in a later chapter.

17. *Relation between bank and depositor.*—Between a bank and a depositor there is a contractual relation, and the contract may or may not give to the depositor the privilege of checking; but, where the so-called ordinary checking account is opened with a bank, the relation established between the bank and the depositor is that of debtor and creditor. The average man, after having made a deposit, thinks, and says, that he has money in the bank, but this is not the view of the situation taken by the law. There is no money in the bank belonging to the depositor. In the eyes of the law the bank is merely a debtor to the depositor to the amount of the deposit,

and is under agreement to pay this amount or any part of it on demand. In the case of a checking account, the bank is assumed to have agreed further to repay either to the depositor, when he shall so order, or to any other person upon the depositor's order, and in accordance with settled commercial customs.

If, instead of depositing money with the bank, the customer deposits checks, the transaction usually amounts to the bank purchasing the check from the depositor and crediting the depositor's account with the amount. The bank then becomes the owner and holder of the check and the depositor becomes liable only upon his indorsement. But sometimes the bank receives the check only "For collection" in which event the bank does not credit the depositor's account until the proceeds of the check have been actually received. Meanwhile it receives and collects the check solely as the depositor's agent and at the depositor's risk.

REVIEW

Explain the difference between negotiability and assignability.

State the requisites of a negotiable instrument.

What is meant by "unconditional promise"; "certainty as to amount"; "fixed or determinable time"?

Outline the law as to omissions and blank spaces in negotiable instruments.

Define a bill of exchange; a check.

What is the relation between a bank and a depositor.

CHAPTER XV

OBLIGATIONS OF PARTIES TO NEGOTIABLE INSTRUMENTS

1. *Liability of the maker of a note.*—The maker of a note promises to pay it to the legal holder according to its terms, that is, upon the day of its maturity. Unless the note is payable at a specified place, such as a bank, it is not necessary for the holder to present it and demand payment at its maturity before starting suit, for the obligation is thrown upon the maker to seek out the holder and make payment when the note becomes due. Curiously enough, this is true even in the case of a demand note, which one might reasonably expect would require at least a demand to put the maker in default. The right of action upon a demand note arises as soon as it is delivered, so in effect the maker of a demand note is liable to pay without a demand. Presentment, however, as will be seen in the next chapter, is necessary in order to charge the indorser of a note.

Where a note is payable at a specified place, at a bank, for example, and the maker is able and ready to pay at that place upon maturity, such ability and willingness are equivalent to a tender of payment by

him, and in such case he is not liable for interest after maturity. By the fact of such ability and readiness to pay, however, he is not discharged from liability to pay the principal amount and interest which has accrued before maturity, if the note by its terms bears interest. Usually the maker deposits money before maturity with a bank at which his note is payable, for the purpose of meeting it when due.

When an indorser has paid the note, the maker, of course, is liable to an action by such indorser.

2. *Liability of a drawee of a bill of exchange.*— What has been said above applies equally to the drawee of a bill of exchange who has accepted the bill, which is then known among business men as an "acceptance." By accepting the bill, the drawee becomes primarily liable, and his position is analogous to that of the maker of a promissory note.

But is a drawee bound to accept a bill? It is the usual practice to address a bill of exchange to a drawee with whom the drawer has money on deposit, or who is indebted to the drawer or holds money as the agent of the drawer. Addressing the bill to such a drawee does not, however, operate as an assignment of any funds in the hands of the drawee, nor is the drawee bound to accept the bill, unless he has previously agreed to do so.

After the bill is presented to the drawee for acceptance, he is allowed twenty-four hours in which to decide whether to accept or not. Should he accept, his acceptance must be in writing and should be upon

the bill itself. Should the drawee fail to return the bill within the time allowed, or should he destroy it, he is deemed to have accepted it. If the drawee refuses to accept the bill, the holder may treat the bill as dishonored and look to the drawer.

3. *Liability of the drawer of a bill.*—The drawer of a bill of exchange is liable to pay the holder, if the bill is dishonored either by non-acceptance or by non-payment after acceptance, provided notice of such dishonor is given to him. He also is liable to any indorser of the bill who may be compelled to pay it. The drawer's liability is, however, conditioned upon prompt action by the holder of the bill, and it therefore behooves the holder of a bill to be alert for his own protection by seeing that the bill is duly presented to the *drawee* for acceptance or payment or both, and to give notice to the *drawer* in case of a dishonor.

Should the drawee refuse to accept a bill after having agreed to do so, thus causing the drawer to become liable, the drawer can recover from him the principal sum and interest and damages occasioned by such refusal.

4. *Rights and liability of the drawer of a check.*—If the depositor has funds in the bank sufficient to meet the check at the time it is presented for payment, he has the right to expect the bank to pay the check, and, if the bank fails to pay, the depositor, like the drawer of any other bill of exchange, can recover any damages caused him by the bank's re-

fusal. This includes damages for injury to the depositor's credit, if the dishonor of the check causes an impairment of his credit. Of course, the bank is not required to make partial payment of a check, and will be justified in dishonoring the check if there are not sufficient funds to meet it in full.

Until the bank has either paid or certified the check, the drawer may "stop the check," i.e., give the bank notice not to pay it. The death of the depositor before certification or payment of the check also revokes the check, even in the hands of a holder in due course. In consequence, if the bank, with notice of the depositor's death, pays the check even to a holder in due course, the bank cannot charge the amount to the estate of the deceased depositor. However, the bank is protected in the case of payment of checks of a deceased depositor, when it has no notice of his death.

If a drawer draws a check upon a bank without having funds there sufficient to meet it, he is guilty of a fraud, and in some states the statute makes such an act a crime. In the state of New York, for example, the law is as follows:

. . . where such check, draft, or order has been protested, the notice of protest thereof shall be admissible as proof of such presentation, non-payment, and protest, and shall be presumptive evidence that there was a lack of funds in or credit with such banks or other depositories.

If a check has been indorsed by the payee to a

holder in due course, the drawer is liable to such holder in case he stops the check, or in case of its dishonor. As was said before, an unreasonable delay in presenting the check does not relieve the drawer of liability upon it, unless the bank has become insolvent during the interval.

If the bank pays a check to the wrong party, the bank must bear the loss, unless the mistake was contributed to by the negligence of the drawer. Thus, for example, a person may negligently allow an incomplete check to get into circulation and, subsequently, the check is filled in wrongfully and reaches the hands of a holder in due course. The bank alone must bear the loss, if it pays a raised or altered check; but the bank may recover its loss from the drawer, if the drawer so carelessly made out the check as to facilitate the fraud, such as by leaving blanks unfilled or leaving a space before or after the words or figures specifying the amount, in such manner that alteration could easily be made.

5. *Certified check.*—When a check is presented to the bank on which it is drawn, the holder may demand payment from the bank or ask that the check be certified. Certification by the bank is equivalent to an acceptance. The balance of the drawer is deemed to be reduced immediately by the amount of the check, and the amount is held by the bank to the credit of the holder of the certified check. Certification of the check, therefore, operates as an assignment to the holder of the check of the specified

amount of the depositor's funds that are in the bank.

The advantage to the holder of having a check certified is that thereafter the bank is substituted in place of the drawer and indorsers as debtor to the holder of the check for the amount involved. When the holder has the check certified, the drawer and indorsers are thereby discharged, but the credit of the bank is usually much higher than the credit of the drawer and indorsers. A further advantage is that the obligation of the bank, unlike that of the drawer and indorsers, will not be discharged by any delay in presentment, short of the time prescribed in the Statute of Limitations. It is to be noted, however, that when the drawer has the check certified and delivers it in this form, he is not discharged.

6. *Form of indorsement.*—The customary method by which a holder indorses any negotiable instrument, whether a note, bill of exchange, or check is by writing his name upon the back of the instrument. An indorsement of an instrument payable "to order," followed by delivery of the instrument, accomplishes its negotiation. In the case of an instrument made payable to bearer, however, no indorsement is necessary, and mere delivery accomplishes its negotiation. Usually, however, the person to whom such "bearer" paper is being transferred will demand that the transferror indorse it, so that the latter may be held liable as an indorser.

The liability of an indorser varies, to some extent, according to the form of the indorsement. We may

note five ordinary forms of indorsement, as follows:

(a) Blank indorsement
(b) Special indorsement
(c) Restrictive indorsement
(d) Indorsement without recourse
(e) Conditional indorsement

A brief discussion of these several forms of indorsements follows:

7. *Blank indorsement.*—When an instrument is made payable to "John Smith or order," it is indorsed in blank if John Smith merely writes upon the back his signature, "John Smith." Since Smith specifies no indorsee, the instrument becomes payable to bearer and may be negotiated by delivery, just as if it had been payable to bearer when issued. Delivery means an intentional transfer, so, if an instrument indorsed in blank falls into the hands of a finder or thief, he will have no rights against any of the parties upon it. But, if the thief or finder himself delivers it for value to an innocent person, the latter may enforce it against the maker or any indorser.

One who indorses an instrument in blank makes a promise to pay the instrument, according to its tenor, to any holder in due course. The meaning of holder in due course will hereafter be explained.

8. *Special indorsement.*—A person into whose hands a negotiable instrument comes may indorse it specially. This he does by designating a payee in either of two ways. He may indorse it "Pay to the

order of John Jones," or "Pay to John Jones," and sign his own name. In either case, the indorsement of John Jones is then necessary to accomplish a further negotiation of the instrument.

It is not necessary in an indorsement of a negotiable instrument, as is commonly supposed, to use order words in the indorsement. An instrument that was negotiable when issued does not lose its quality of negotiability unless restricted. Smith's indorsement "Pay to John Jones," omitting the order words, is not a restrictive indorsement. Jones could himself continue the negotiation of the instrument by a blank indorsement or by an indorsement in one of the other forms.

There is a very practical advantage in using a special indorsement. As has been seen, one who indorses in blank becomes liable to a holder in due course to whom a thief or finder negotiates the instrument. Thus, if Smith receives a check which he desires to deposit in his bank and merely signs his name upon the back and mails it to the bank, he becomes liable for value to an innocent holder, into whose hands it may come if the check is lost or stolen. But, by using a special indorsement, "Pay to the Mountain Trust Company," the risk of such liability is avoided.

9. *Restrictive indorsement.*—A holder may desire to restrict his liability more narrowly when he transfers the instrument, by exercising some control over its proceeds. He has the right to do this by indicat-

ing the purpose for which the instrument is negotiated. Examples of such restrictives are: "Pay to John Jones only"; "For deposit in the Mountain Trust Company"; "Pay to John Jones for collection." One to whom an instrument is transferred is bound, at his peril, to take notice of the indorsee's right to dispose of the instrument. John Jones, or the bank under the above indorsements, has only limited authority by the terms of the indorsement, the authority to present the note and receive payment. All persons are warned, however, that the indorsee has no authority to negotiate the instrument further.

10. *Indorsement without recourse.*—The words, "Pay John Jones without recourse" (Signed) "John Smith," would constitute an indorsement without recourse to indorser. Its legal effect is that Smith transfers all his rights in the instrument to Jones, but that Smith assumes no obligation, whatever, to Jones or to any subsequent holder of the note, except to warrant that the instrument is genuine, has not been forged or altered, that he has good title to the instrument, that all parties to the instrument are competent, and that he knows of nothing to render it invalid. But he does not agree to pay the instrument in case the person originally liable upon it fails to pay.

11. *Conditional indorsement.*—Such indorsements as "Pay to Mary Smith when she arrives at twenty-one years of age," "Pay to Dewey and Hunter when the ship Franconia next arrives at New York," are

conditional. If an instrument were originally made payable upon such a condition, its negotiability would be destroyed, but, if the bill or note as originally made contains words of negotiability, such an indorsement is held not to destroy its negotiable character or quality, for the instrument on its face still expresses an absolute promise or obligation to pay according to its terms. The condition attached to the indorsement affects only the question as to when payment is to be made.

12. *Liability of indorser.*—Subject to the qualifications set out above as to indorsers without recourse, each indorser warrants that the instrument is genuine and in all respects what it purports to be, that he has good title to it, and that all prior parties had capacity to contract. He can be held liable for a breach of these warranties by any subsequent holder of the instrument.

In addition, the indorser, by the mere fact of indorsement, agrees that the instrument is at the time of his indorsement valid and enforceable; he agrees that it shall be accepted or paid, or both, according to its terms, and that, if it be dishonored and the necessary proceedings on dishonor be duly taken, he will pay the amount thereof to the holder or to any subsequent indorser who may be compelled to pay it.

It will be noticed that the indorser of a promissory note enters into a different contract from that of the maker of the note. The maker agrees to pay in accordance with the terms expressed upon the face of

the note. The terms of his contract are, therefore, embodied in the note itself. The terms of the indorser's contract, however, do not appear upon the face of the note or elsewhere. With the exception of the provisions previously discussed in connection with the kinds of indorsement, the terms of the indorser's liability are fixed by law.

13. *Accommodation indorser.*—Often the credit of the maker of a promissory note needs to be reinforced. This may be accomplished by having some other person or persons indorse it, and thus lend their credit to the instrument. The persons so indorsing, for no consideration, but merely to lend their credit, are known as accommodation indorsers.

Any party who has signed as maker, drawer, or acceptor of an instrument without consideration and for the sole purpose of lending his credit to some other person is called an accommodation party. An accommodation party becomes liable to all subsequent holders for value, even though such holders at the time of taking the instrument know him to be an accommodation party. In placing his name upon a negotiable instrument, a party extends an invitation to holders to deal with it on his credit.

Suppose, for example, that John Doe desires to borrow money from the bank but has no security to offer the bank. Brown, being in good credit and willing to assist Doe, might make and deliver to John Doe his own note payable to the order of Doe, which note Doe could indorse and deliver to the bank and

thus procure the loan. In such case, Brown is an accommodation party. Both Brown and Doe are liable to the bank on the note, but, since Brown received no value and gave the note only for the accommodation of Doe, the latter could not hold Brown liable upon the note at maturity.

14. *Holders in due course.*—A holder of an instrument is the one who is within the description of the instrument and in possession of it. He may be the payee, or an indorsee, or, in the case of bearer paper, he is the one in possession. Unless he is a holder in due course, the holder takes the title of his predecessor subject to all its defects. He is a mere assignee, and, like the assignee of any contract, his rights are subject to any defense which might be set up against the assignor.

A holder in due course, however, occupies a more advantageous position. He, also, is within the description of the instrument and in possession of it, but he takes a title free of infirmities existing in the title of prior parties and free of defenses which they may have between themselves. He may enforce the instrument in his own name against all parties liable thereon. To constitute a person a holder in due course, there are certain requisites that must be carefully observed:

(a) The first requisite is that the instrument must be a negotiable one. The difference between negotiable and non-negotiable instruments has been described in a previous chapter.

(b) The second and a somewhat similar requirement is that the instrument be complete and regular on its face when it is taken. If there is any evidence of alteration or other irregularity upon it, no person who takes it can allege that he was without notice of such defect. A check made payable to "William R. Browne," bearing the indorsement of "William R. Browne," carries its own notice to all who take it that the indorsement is irregular.

(c) The instrument must have been taken by the holder before it was overdue, and without notice that it had been previously dishonored, if such was the fact. In the case of demand instruments, if the instrument is negotiated an unreasonable length of time after issue, the taker is not a holder in due course. (One who takes an instrument after maturity may sue upon it for payment, but his rights are only those of a mere holder.)

(d) The instrument must have been taken in good faith, that is without notice of any defenses or of defects in the title of the person transferring it to the taker. One acts in bad faith who has knowledge of circumstances which ought to arouse his suspicion as to infirmities in the paper and who refrains from making an investigation.

(e) The holder must have given value. The value meant is any consideration that would support a simple contract, with the addition, however, that an antecedent indebtedness, such as a debt barred by the statute of limitations or a bankruptcy decree, is deemed to be value for the transfer of a negotiable instrument.

All the above requisites must be fulfilled to constitute one a holder in due course. If he fails in one

of them, he is a mere assignee and, hence, has only the rights of action and recovery that are open to a regular assignee.

It should be added, however, that, if one though not a holder in due course derives his title from a holder in due course, without any fraud or illegal act on his part, he will acquire the rights of the holder in due course against the prior parties upon the instrument.

REVIEW

State the liability incurred by the maker of a promissory note; of the drawee of a bill of exchange; of the drawer of a bill of exchange.

What are the liabilities of banks in relation to checks?

Define five types of indorsement.

Explain the liability of indorsers.

State the requisites necessary to make one a holder in due course.

CHAPTER XVI

PRESENTMENT, NOTICE, AND DISCHARGE OF NEGOTIABLE INSTRUMENTS

1. *Necessity for presentment.*—As we have seen, failure to present a negotiable instrument for payment does not discharge the maker or acceptor—the persons primarily liable—but presentment for payment is of vital importance in connection with the obligations of persons secondarily liable, viz., all indorsers of the instrument and also the drawer of a bill of exchange.

The indorser of a negotiable instrument does not make an absolute and unqualified promise to pay. His promise is contingent not only upon non-payment by the maker but also upon the strict performance of certain conditions by the holder of the instrument. These conditions are: that the holder, on the day the instrument falls due, present it to the person originally liable thereon and demand payment; and that, if payment is not immediately forthcoming, the holder give the indorser immediate notice of the dishonor of the instrument. Should the holder consent to any delay in payment or to any change of the terms of the instrument, the effect is to relieve all prior indorsers absolutely from liability.

2. *What constitutes sufficient presentment.*— When the instrument is payable on a specific date, it must be presented for payment on the day it falls due. When it is payable on demand, it must be presented within a reasonable time after its issue, or, in the case of a bill of exchange, within a reasonable time after it reaches the hands of the holder making the presentment. It must be presented by the holder, or by some person authorized to receive payment on his behalf, at a reasonable hour on a business day, and it must be presented to the person who is primarily liable on the instrument—in other words, to the maker of a promissory note or to the acceptor of a bill of exchange. If the person so liable is absent or inaccessible, the presentment may be made to any person found at the place of presentment.

If the instrument specifies a place of payment, for example, the Monroe National Bank, it must be presented at the bank. If no place of payment is specified in the instrument, but the address of the person to make payment is given in the instrument, presentment should be made at that address. If the person to make payment does not specify any place of payment or give his address, the instrument may be presented at his business place or his residence.

If the place of business and the place of residence are unknown, the holder must make diligent inquiry and effort to ascertain the residence or place of business within the state or to find the person obligated to pay and present the instrument. The holder is not

obliged to go outside of the state in which the instrument is payable in order to find the debtor. Reasonable diligence on the part of the holder is all that the law requires in any case.

A sufficient presentment requires that the instrument be actually exhibited to the person who is to make payment, accompanied by a demand for payment. Of course, this presentment may be made to an agent of the person primarily liable, if the agent is authorized to make or refuse payment on behalf of his principal.

When an instrument is made payable at a bank, it is equivalent to an order to the bank to pay the sum for the account of the person making the instrument so payable. Therefore, if the note or bill is payable at a bank, presentment to any employee of the bank at the bank during business hours, in the manner in which checks are usually presented for payment, is sufficient. In fact, if the maker had no funds there to meet the instrument at any time during the day, presentment after business hours but before the bank is closed for the day would be sufficient.

When the note is made by partners, presentment to one partner is sufficient, but, if it is made by several persons not partners, presentment must be made to them all, unless a place of payment is specified in the note.

When the principal debtor of the instrument is dead, presentment may still be made at the place of payment, if one is specified in the instrument. If

no such place is specified for payment, the instrument must be presented to the executor or administrator of the deceased, if with reasonable diligence he can be found.

If a day of payment falls upon a Sunday or holiday, the instrument is payable on the next succeeding day. In New York, Saturday is a half holiday. Instruments falling due on Saturday are to be presented for payment on the next succeeding business day, but, if payable on demand, the holder has an option of demanding payment on Saturday before twelve o'clock noon.

3. *Presentment of a bill of exchange.*—The reader should be reminded that, in the case of a bill of exchange, two presentments, one for acceptance and one for payment, may become necessary. For example, take the case where a bill of exchange is drawn, made payable 30 days after sight. The holder must present the bill to the drawee for acceptance. If the bill is not accepted, it is dishonored; but, if the drawee accepts it, it must again be presented, this time for payment, 30 days after acceptance.

4. *Time for presentment of a check.*—A check stands upon a different footing, to some extent, from other types of bills of exchange. Failure to present a bill for payment at the proper time discharges the drawer and indorsers. Failure to present a check within a reasonable time after it was issued discharges the indorsers. It does not discharge the drawer unless he can show that he was damaged by

the delay, and then only to the extent of his loss. For example, the drawer has sufficient funds in the bank to meet his check if duly presented. There is a delay in presentment and the bank fails in the interim, ultimately paying 50 per cent to depositors. The drawer is discharged to the extent of 50 per cent of the check.

Whether a check has been presented for payment within a reasonable time depends upon the circumstances peculiar to each case, and no definite time limit can be set down. These circumstances include distance, the course of mails, and the accepted usage of the trade or community. If the holder deposits the check in his own bank, instead of presenting it to the bank on which it is drawn, his bank assumes the obligation to present it for payment within a reasonable time and, if the bank neglects to fulfill this duty, and the fund which is on deposit to meet the check is lost, the loss falls on the bank rather than upon the depositor.

5. *Notice of dishonor.*—When a negotiable instrument has been dishonored, as when the maker of a promissory note does not pay it on the day it is due, or the drawee of a bill of exchange fails to accept it when presented for payment, notice of dishonor must be given to the drawer of the bill of exchange and to each indorser of a promissory note or of a bill of exchange. A drawer or indorser to whom such notice is not given is discharged, unless the circumstances were such as to excuse notice in accordance

with the rules which will be stated. The notice may be given:

(a) By the holder or his agent
(b) On behalf of any party to the instrument, who might be compelled to pay the holder and who then would have the right to reimbursement from the prior indorser or the maker

Notice of dishonor is frequently given by a notary public or other agent who has been employed to present instruments for payment. In such a case, the agent or notary acts on behalf of all parties to the note, subsequent to the person who is primarily liable, and may give notice of dishonor on behalf of all such parties, regardless of whether or not he has been specially authorized to do so. But, since the holder may receive adequate satisfaction himself and may not be interested in preserving the rights of the prior parties to the instrument, every such party has the right to inform himself as to the payment or nonpayment of the instrument and give the notice to persons from, or through whom, he received the instrument. In consequence, the notice, although customarily given in writing, may be given orally and no defect in such notice will invalidate it unless the defect has actually misled the person to whom the notice is given.

When previous indorsers are partners, notice to one of them is sufficient, but, if joint parties are not partners, notice must be given to each of them. When any party is dead, notice must be given to his

administrator or executor, if one can be found. If there is none, notice may be sent to the last residence or place of business of the deceased. These requirements are very similar to the requirements for presentment for payment.

6. *Within what time must notice of dishonor be given?*—When the person giving and the person receiving notice reside in the same place, notice of dishonor must be given at one of three places within the following limits of time:

(a) At the place of business of the person to receive the notice before the close of business hours on the day following the dishonor
(b) At the residence of the person to receive notice before the usual hours of rest on the day following the dishonor
(c) By depositing it in the post-office in time to reach the person to receive it on the day following the dishonor

If the parties reside in different places, the notice may be given by mail by depositing it in the post-office in time to go by mail the day following the day of dishonor, or by the next mail. If the notice is not sent by mail, it must be given within the time during which a notice given as stated above would have been received in usual course.

When a notice of dishonor has been duly addressed and deposited in the post-office within the time allowed, the sender is deemed to have given due notice notwithstanding any loss or delay in the mails. The

notice may be deposited in any branch post-office or letter box with the same effect.

When an intermediate indorser receives a notice of dishonor, he has, after the receipt of such notice, the same time for giving notice of dishonor to former parties, and may give the notice in the same way. In general, the notice of dishonor must be addressed to a party at the address given by him upon the instrument. If he has given no such address, the notice should be addressed to his customary post-office address. If he lives in one place and has a place of business in another, the notice may be sent to either place. If he is known to be sojourning in another place, the notice may be addressed to him there.

7. *Protest.*—The protest is a formal certificate executed by a notary certifying that a bill or note described therein has been presented for acceptance or payment, as the case may be, and that acceptance or payment has been refused. The instrument must set forth details as to time and place and names of parties. This certificate, when properly executed, is useful as evidence in an action upon such an instrument to prove the dishonor. But protest is legally necessary only in the case of one class of instruments, foreign bills of exchange, i.e., bills of exchange in which the drawer and drawee reside in different states or countries. Protests by notaries are recognized the world over, and, when it is intended to protest a bill or note, a notary should be employed to make presentment if one can be found.

8. *Discharge by payment.*—A negotiable instrument is discharged most commonly by payment, of course. Payment by the primary debtor to the holder made in good faith, and without notice of defective title to the bill, at or after the maturity of the instrument, to the holder, discharges the liability of all parties to the instrument. If a person secondarily liable makes payment, the maker is not discharged, however, and is liable to the indorser who paid the obligation.

Payment, to operate as a discharge, must be made to the person entitled to it. Thus, if an instrument is indorsed to B and is stolen by C, who secures payment by representing himself to be B, the obligation is not discharged. The same is true, if payment is made to the holder under a forged indorsement.

9. *Discharge by cancellation.*—A holder or his agent may intentionally cancel a bill or note, and, if the cancellation is apparent upon the face of the instrument, it is discharged. The cancellation may be by writing the word "paid" or "discharged" across the face of the instrument or by destroying it altogether. If a cancellation is made unintentionally, or by mistake, or without the authority of the holder, it is inoperative, but the burden of proof rests upon the person who alleges that the cancellation was made unintentionally, or by mistake, or without authority.

10. *Discharge by alteration.*—An instrument that is materially altered without the assent of all parties liable upon it, is discharged except as against

a party who himself has made, authorized, or assented to the alteration, or subsequent indorsers.

Any alteration which changes: (1) The date; (2) The sum payable, either for principal or interest; (3) The time or place of payment; (4) The number or the relations of the parties; (5) The medium or currency in which payment is to be made; or which adds a place of payment where no place of payment is specified, or any other change or addition which alters the effect of the instrument in any respect, is a material alteration. (Sec. 125, Negotiable Instruments Law.)

11. *Discharge of parties secondarily liable.*—Parties secondarily liable may be discharged, as has already been noted, by a failure to make a due presentment. Any discharge of the primary debtor operates to discharge all the parties who are liable to pay only if he does not pay. Thus, if a holder discharges the maker, he cannot hold the indorser because, by releasing the maker, he is depriving the indorser of his chance to collect from the maker. So, also, the discharge of an indorser by the holder releases all subsequent indorsers.

A further defense that may become available to persons secondarily liable upon negotiable instruments, i.e., the drawer of a bill of exchange or the indorsers of a bill or note, is that, if the holder enters into a binding agreement with the maker of a note or acceptor of a bill of exchange to extend the time of payment, the drawer and indorsers are relieved from liability upon the instrument. As we have seen

above, the liability of these parties is strictly conditional and contingent; they have the right to insist upon strict performance of the conditions by all subsequent holders.

12. *"Real" defenses.*—A fact or set of facts which will defeat an action for the payment of a negotiable instrument is called a defense. Defenses are divided into two classes—*real* defenses, and *personal* defenses. A real defense is one which is good against a holder though he is a holder in due course. A personal defense is one which is not available as against a holder in due course. Real defenses include incapacity, illegality, usury, and forgery, and these must now be briefly considered.

13. *Incapacity.*—Since a minor cannot bind himself, except for the reasonable value of necessaries, no minor can be held liable upon a bill or note even by a holder in due course. As to the minor, the instrument is void, if the minor wishes to take advantage of the defense.

On the other hand, by special provision of the Negotiable Instruments Law, if a minor acquires a bill or note and indorses or assigns the instrument to another, the new holder acquires title to the instrument and can enforce it against all parties to the instrument except the minor.

Incapacity caused by insanity or extreme intoxication destroying mental capacity are defenses to the same extent as infancy. They are good defenses when set up by the lunatic or drunkard, or by their

guardian or committee, even against the holder in due course, but no other party to the instrument can take advantage of such a defense.

14. *Illegality.*—The law never requires anyone to do an unlawful act, nor will it punish him for refusing to perform such an act. Neither will the law assist anyone to collect compensation for doing an unlawful thing. Accordingly, when statutes provide that contracts with reference to the doing of a certain thing shall be void, no bill or note given in payment for doing such unlawful act, or which provides in itself an obligation to do such forbidden act, can be enforced against any one.

On the other hand, it would be against the interests of the community to make it necessary for each person, taking a bill or note in the course of business, to risk the loss of the amount involved because it might appear that preceding parties to the instrument had made unlawful use of it. Therefore, unless the statute of the state in which the bill or note is executed expressly provides that such an instrument shall be absolutely void, the instrument will be enforced in the hands of subsequent holders in due course.

15. *Usury.*—Statutes in many states make usury a real defense. Usury consists of intentionally taking or contracting for a higher rate of interest upon a loan than is allowed by law. New York is one of the states making an usurious contract utterly void and unenforceable even in the hands of a holder in due course.

It should be noted, also, that to make usury good as a defense, the instrument must be usurious in its inception, i.e., the bargain that led to the making of the note or bill must have been usurious. But, if an instrument was free from such taint as between the original parties to it, the mere transfer or discount of the instrument for more than legal interest is not usurious and the holder may recover the full amount of the instrument from any of the prior parties thereto.

16. *Forgery.*—The placing of a signature upon a negotiable instrument without authority of the person whose signature it purports to be, or counterfeiting or altering or erasing a genuine negotiable instrument or any part of it with intention to defraud, followed by the delivery of the instrument, is forgery. Forgery confers no rights upon any person as against the person whose name is signed without authority or whose promise is altered without his authority. But the person whose name is forged, or whose note is altered, must repudiate the forgery as soon as he discovers it, and must act fairly and in good faith to all others in regard to the instrument.

If a party receives a bill or note that has been forged, and in ignorance of the forgery indorses the instrument to another, by doing so he warrants to the latter that the instrument is genuine. In such case, although the instrument would be worthless in the hands of the first party, yet he is liable to his indorsee. Since he has warranted the instrument to

be genuine, he will not be permitted to assert later that the instrument is not genuine, especially when such a change of position on his part would cause loss to the person dealing with him. This illustrates the so-called rule of estoppel. Another example occurs where an instrument is shown to a supposed maker or indorser and he is asked if his signature is genuine, and, instead of denying, he so acts as to mislead the holder to the latter's damage. In this event he would be held liable on the instrument on the ground of estoppel.

It sometimes happens that the forgery is not discovered until after the instrument has been paid. In such a case, the party who has paid the money upon the forged instrument may generally recover the money from the person to whom he has paid it. This is an illustration of the rule that one who pays money to another by mistake may recover it upon discovery of the mistake, unless the person receiving the money was unaware of the mistake and has so changed his position that a recovery by the person who paid would throw the loss unfairly upon his shoulders.

The situation that arises where the drawee pays the bill to a holder in due course, however, should be noted. When a bill is presented to a drawee for acceptance or for payment, the drawee is assumed to know the drawer's signature, and, if he accepts or pays the instrument, he thereby treats the drawer's signature as genuine and in effect warrants it to be

so. Therefore, he cannot recover the sum paid, but is left to whatever remedy he may have against the forger. Perhaps the commonest illustration of this rule is the case of a bank which pays a check upon the forged name of its depositor. If the forger himself presents the check to the bank, the bank may recover from the forger, but, if the check is paid by the bank to a holder in due course, the bank can recover neither from the depositor, for it was not his act, nor from the person receiving payment, for he has been deceived by the bank's assumption that the signature was genuine.

Defenses other than the real defenses above considered are personal and, as previously stated, are not available against a holder in due course. The nature and effect of these defenses may be illustrated as follows. Assume that A, by fraud, induces B to execute and deliver to him a negotiable promissory note. If A sues B on the note, his fraud affords B a defense. If, however, before the due date of the note A indorses and delivers it to C for value, and C has no notice of A's fraud, the fraud will not afford B a defense to a suit by C upon the note. Nor would it be available to B as a defense to a suit by one to whom C may have passed his title to the note.

REVIEW

Explain what constitutes a sufficient presentment.

State when, how, by whom, and to whom, notice of dishonor must be given.

Define "protest" and explain when it is necessary.

Outline the ways of discharging a negotiable instrument.

What are "real defenses" to actions involving negotiable instruments? How do they differ, in legal effect, from personal defenses?

CHAPTER XVII

PARTNERSHIP

1. *Definition of Partnership.*—The Uniform Partnership Law, which has been adopted in seventeen states, defines a partnership as "an association of two or more persons to carry on as co-owners a business for profit." A partnership differs from a corporation in that the corporation in the eye of the law is an artificial person created by the state and has a legal existence, or entity, entirely apart from the officers and stockholders. On the other hand, the law does not recognize the partnership firm as something apart from the members who make it up. At law the partnership and the partners are one.

The legal nature of corporations is described in textbooks dealing with business organization, and the nature of a partnership and many of its legal aspects also are described in such volumes.

Partnership is a form of business organization that involves considerable risk, because not only is a partner's investment in the partnership exposed to loss, but also his entire private fortune may be sacrificed through the failure of the partnership enterprise, or the dishonesty or shortsightedness of a copartner. It is of the highest importance, therefore, for a busi-

ness man either to avoid entering into the partnership relation or, at all events, to choose his associates with the utmost care.

2. *When a partnership exists.*—Most partnerships are based upon an agreement between two or more persons competent to make a contract, more or less formal in form, to combine their labor, skill, and property, or some of these, for the purpose of engaging in a lawful business with the object of making and sharing in the profits of the enterprise. Because of the importance of the relation, common prudence suggests that the agreement should be in writing containing all the terms of the understanding. An example of such an agreement may be found in any text on business organization.

In general, whenever there is a joint interest in the conduct of a business, if all are participating in the profits and losses and if there is mutual agency, there will be a strong presumption that a *true* partnership exists. A sharing of profits in itself, under the Uniform Partnership Act, creates a presumption that the parties so sharing are partners, but it is not conclusive. The profits, it should be noted, must be shared as *profits*. Thus, if one party is receiving a share of the profits in lieu of wages, or as interest on a loan, or as rent, the presumption will not arise.

3. *Partnership by holding out.*—Occasions may arise when persons will be held to be partners so far as third persons are concerned, although they may not, as between themselves, have had any such

intention. This is the situation when a person, with his consent, is held out to third persons as a partner. The Uniform Partnership Act contains the following provision as to this subject:

> When a person, by words spoken or written or by conduct, represents himself, or consents to another representing him to anyone, as a partner in an existing partnership or with one or more persons not actual partners, he is liable to any such person to whom such representation has been made, who has, on the faith of such representation, given credit to the actual or apparent partnership, and, if he has made such a representation or consented to its being made in a public manner, he is liable to such person, whether the representation has or has not been made or communicated to such person so giving credit by or with the knowledge of the apparent partner making the representation or consenting to its being made

An examination of the statute shows that one will be held liable as a partner where:

(a) He has either so conducted himself as to give a reasonably prudent man the impression that a partnership exists, or has consented to such conduct on the part of another person
(b) Where the third party in the exercise of ordinary prudence has relied upon such misrepresentation and has been misled by it

Knowingly permitting one's name to be used upon signs or letterheads, or permitting one's self to be referred to as a partner, or failing to give notice to persons who dealt with the firm when one is retiring from a partnership are typical acts which the courts

have treated as "holding out to the world" the existence of a partnership.

4. *Partnership capital and property.*—The capital of the firm is the sum total of money and property that the partners have agreed to contribute for use in the business. Sometimes one partner contributes actual cash, another may contribute the use of real estate, and another may contribute only his labor or skill.

The property of the firm includes the goodwill and all the tangible capital that has been contributed and that remains in the hands of the firm and also every valuable thing that has been in any way acquired and held by the partnership. Unless a contrary intention appears, property acquired with partnership funds is partnership property, whether or not it was acquired ostensibly as the property of the firm or of one of the individual members.

At common law a partnership could not hold title to real property, but it could be held by one of the members for the benefit of the firm. Under the Uniform Partnership Law, however, real property may be acquired, held, and conveyed in the partnership name.

5. *Partner's interest in firm property.*—All of the members of the firm are interested in the whole of the partnership property, but no partner can claim the ownership of any particular part or any particular chattel belonging to the firm. They are neither joint tenants nor tenants in common. If they were

joint tenants, the share of one partner would upon his death go to his surviving partners for their individual use, but, in the case of the death of a partner, his interest in the partnership property passes to his surviving partners only for the purpose of winding up the firm. After the firm debts are paid, the next of kin or legatees of the deceased partner become entitled to his net share of the partnership property. A partner's interest in the firm property is also unlike that of a tenant in common, because a tenant in common may transfer his interest and his transferee becomes a tenant in common with the remaining coowners, but the attempted transfer by a partner of his interest in the firm property, instead of substituting his transferee as a partner, operates merely to cause a dissolution of the firm.

6. *New partners.*—A new partner cannot be introduced into the firm without the consent of all the members.

What really takes place in legal contemplation, when a new partner is taken in, is the dissolution of the old partnership and the formation of a new one.

A new, or incoming, partner takes over all the rights and liabilities of a partner from the date of his admission. The capital he contributes may also be held for a debt of the partnership that existed before his admission. He will not be liable personally, however, for any pre-existing debt.

7. *Dormant and secret partners.*—On occasion, a person may be a member of a firm without his con-

nection being disclosed to third persons. He may contribute capital, for example, and share in the profits, but take no active part in the business. In such a case, he is known as a dormant or silent partner. He may, however, take an active part in the firm affairs, but for various reasons his connection may be kept secret. He is then known as a secret partner. In either case, he will be liable upon the obligations of the firm should his connection be discovered.

8. *Limited partnerships.*—By statute in New York and some other states, provision is made whereby one may become a special partner with liability limited, as in a corporation, to the amount of the capital contributed by him. A partnership having such a member is known as a limited partnership. Such a partnership can be formed only by filing a certificate as provided by the statute and it must have at least one general partner with unlimited liability. Furthermore, a limited partner loses his protection if he takes any part in the control of the business. The principal purpose of such partnerships is to limit the liability of one or more partners and to preserve their rights to deal with the copartners, as an outsider would. Since corporations are now readily formed, such purpose is more effectively accomplished through the organization of a corporation.

9. *Rights of firm creditors.*—Mention has been made of a partner's liability for the firm debts. Except in the case of a limited partner, each partner is personally liable for the entire amount of a firm

obligation, regardless of his proportionate interest in the firm. A judgment creditor of the firm may proceed, at his option, against the firm property, or against the individual property of all the partners, or even collect the entire amount from one partner alone by levying upon his individual property. In the latter case, such a partner's only relief is to compel his copartners to contribute their share as fixed by the partnership agreement. This requires a dissolution of the firm and final accounting.

10. *Rights of individual creditors of a partner.*—A judgment creditor of an individual partner, of course, may proceed against the individual property of his debtor in the usual way. Under the provisions of the Uniform Partnership Act, such a creditor may procure from the court a "charging order" which, without interference with the property of the firm, charges the share of the debtor partner with payment of the debt, and, if necessary, the court will appoint a receiver of the debtor partner's share for the purpose of collecting it and satisfying the judgment.

The conflicting claims of firm creditors and of the creditors of the individual partners have given rise to many rules. Space will not permit of their consideration here. Their application requires the advice of counsel.

11. *Duties and rights of partners among themselves.*—The relations of the partners to each other and the duties of each are defined in part by the

agreement, to which the law adds the following requirements:

Each partner must act in the highest good faith toward his copartners, and upon demand must give them true and full information of all things affecting the partnership.

Each partner is obliged to account for any benefit, and hold for the partnership, as trustee, any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership, or from any use by him of its property.

In the absence of an agreement, a partner must devote his time and attention to the partnership affairs and has no right to give his time, skill, or efforts to any other business to the prejudice of the partnership.

All partners have equal rights in the management of the business, and the majority rules, but no act which is in violation of any agreement between the partners may be done rightfully without the consent of all.

No partner without the consent of his copartners can use partnership property in payment of his own debts or for his own purposes.

If a partner has made any advance beyond the amount of capital which he agreed to contribute, he is entitled to interest from the date of the advance and to reimbursement for the sum so advanced before any distribution of profits takes place.

After advances are met and the firm debts paid, each partner, in the absence of special agreement, shares equally in the proceeds of the firm assets. Each partner must contribute equally to the losses sustained by the partnership.

12. *Enforcement of obligations among partners.*— A peculiarity of the legal relations existing among partners is found in the fact that, if a partner violates his obligation to his associates, this does not give them

a right to sue him. It may entitle them to damages or to an accounting, but the enforcement of their rights is in general postponed until the dissolution of the partnership and the winding up of its affairs, at which time all claims and controversies among the partners connected with the firm are taken into account.

13. *Power of partner to bind firm by contract.*— Every partner is a general agent of the firm for the purpose of its business. As long as the partner is acting apparently within the scope of the firm's business, a person dealing with him has the right to assume that the partner has authority to act for the partnership in the matter in hand. The partnership is bound by such an act unless the partner actually had no authority to act for the partnership as he did in the particular matter, and the person dealing with him knew it. An act of a partner that is not apparently usual for carrying of the firm's business in the customary way does not bind the firm unless it was authorized by the other partners.

By "scope of the firm business" is meant the limits of that kind of business fixed by the usual custom of the place and trade. To put it another way, a partner can bind his firm to third persons by such acts as are reasonably adapted to carry on the business of the partnership and that do not go beyond the general usages or customs of other firms engaged in the same or a similar business.

Bearing in mind that the partner is an agent and

the partnership a principal, that which has been said under the heading of principal and agent in a previous chapter is applicable to the powers of a partner, especially as to the apparent scope of authority, secret limitations upon authority, and the ratification of unauthorized acts, either by express words, by acquiescence, or by having adopted or ratified previous acts of a similar nature. For example, a partner in a trading partnership could bind his firm by a promissory note or trade acceptance given for the purchase price of a large consignment of goods apparently adapted to use by the firm, but a firm of doctors or lawyers would not be bound by a firm promissory note so given, unless it was authorized or ratified by the other partners. It is not the ordinary practice of such firms to use the firm credit in that manner. A partner may borrow money for the firm and bind the firm for its repayment even by giving a chattel mortgage on the firm property. This is true, even though he misappropriates the money, provided the borrowing was apparently a reasonable and ordinary incident in carrying on the firm's business and the lender believed it to be a partnership act.

Hence, a third party may safely pay to any partner money due the firm, or give a note or settle an account with him, or even compromise a dispute with him if it arises out of the usual course of the partnership business. But, if it is an unusual controversy, such as a damage suit for negligence or the settlement of litigation actually pending, the copartners

would be bound by such a settlement only if they had expressly authorized it. One partner cannot bind his copartners by consenting to arbitrate a claim made by or against the firm.

14. *Fixed property.*—In selling property of the partnership, while each partner has implied power to sell firm property when that is the customary way to carry on the firm business, no partner has implied power to sell all the property of the firm or to do any other act that would make it impossible to carry on the ordinary business of the partnership. A partner in a mercantile house might sell the entire stock of goods, for it is the firm's business to buy and sell goods. But he could not sell the store fixtures or the truck used for deliveries, for it is not the firm's business to buy and sell store fixtures or trucks. Their sale might prevent the firm from carrying on its business.

Again, one partner alone cannot sell or convey real estate held as partnership property, for two reasons. In the first place, real estate can be transferred only by a deed which must be under seal, and it is the general rule that one partner cannot bind the others by an instrument under seal. In the second place, it is not the ordinary business of any but real estate dealers to sell real estate. Even in the case of a partnership dealing in real estate, the technical nature of a transfer of real estate ordinarily makes it desirable, at least, that a deed should be signed by all the partners.

15. *How a partner's authority is shown.*—It must not be forgotten that the third party cannot safely rely upon the representations made by a partner as to the extent of his authority. Whenever there is the slightest doubt as to a partner's authority to bind his copartners by a particular act or contract, confirmation of his authority should be obtained from the copartner upon whose financial responsibility reliance is to be placed.

Representations or declarations by a partner as to his authority must not be confused with statements or admissions made by him concerning firm business, when he is actually acting within the scope of the partnership business. Such admissions or declarations are binding upon the firm, and may not be contradicted later to the disadvantage of a third person who believed and acted upon them. Thus, a statement by a partner of a firm of stockbrokers to the effect that he was authorized by his copartners to accept money for investment in mortgages upon real estate would not be binding upon his copartners. But if the partners were actually engaged in that business and one of them represented to a third person that money given him to invest in a particular mortgage had actually been so invested, such representation would be evidence against his copartners, for it would be incidental to the ordinary course of business of the firm.

16. *Firm bound by wrongful act of partner.*—We have been considering those acts of a partner which

may give third persons contract rights against the firm. A partner, by wrongful acts, may give third persons claims for damages against the firm. A partner's wrongful act or wrongful omission to act in the ordinary course of business of the partnership, causing loss or injury to a third person, gives the latter a right of action, not only against the wrongdoer, but, also, and to the same extent, against his partners. This rule extends to liability for fraud, for slander, and for misappropriation of funds, but does not impose criminal liability upon the innocent partners.

17. *Dissolution.*—The dissolution of a partnership is the change in the relation of the partners caused by any one of them ceasing to be associated in the operation of a business. This must be distinguished from the winding up of a business, in which event the partnership continues until the winding up of the partnership affairs is completed.

REVIEW

State why there is legally considerable risk in the partnership form of enterprise.

Give the principal test for determining whether or not a true partnership exists.

Describe a partner's interest in firm property.

Outline the rights of firm creditors; of individual creditors.

Outline the duties and rights of partners among themselves.

Explain the power of a partner to bind the firm to third persons by contract.

CHAPTER XVIII

CORPORATIONS

1. *Introduction.*—The nature of a corporation; the legal concept of the corporate existence, or entity, separate and apart from its members; the organization and dissolution of corporations; the rights and liabilities of stockholders; and the powers and duties of directors and officers are discussed to a considerable extent in texts on business organization. The reader will find it profitable to read chapters on these topics in connection with this chapter. The following sections will deal largely with additional matters in connection with corporations without attempting to repeat what is discussed in business organization texts.

2. *Corporations irregularly organized.*—A corporation derives its powers from the state. Unless its organizers comply with the provisions of the law pertaining to the creation of a corporation, it will not actually come into being. For example, suppose it was discovered, while an organization was conducting its business as a corporation, that one of the incorporators who signed the certificate of incorporation was not of age. The law requires the incorporators to be of full age. The organization would

not, then, in law, be a validly existing corporation. Nevertheless, if there is a valid law under which a corporation might be organized, and an *honest* effort is made to comply with the law, followed by an actual assertion and exercise by the organizers in good faith of corporate powers, the organization will be treated as a *de facto* (existing actually and in fact) corporation. This means that, as against everyone but the state, such an irregularly organized association will be regarded as a corporation and no one except the state can attack the regularity of its organization. Thus, if a person makes a contract with a *de facto* corporation, dealing with it as a corporation, he will not be allowed to avoid his promise upon the ground that there was no corporation in law, nor can the *de facto* corporation avoid its promise to him.

3. *Defective incorporation.*—If there is no bona fide attempt to organize a corporation under the law, but one or more persons assume to act as a corporation, there is not even a *de facto* corporation in existence. A mere agreement among several persons to act as a corporation would be insufficient. There is in such cases a considerable diversity of decision in the various states as to the result when third persons deal with an association that pretends to be a corporation. Some hold the members to be personally liable as though they were partners. The majority, however, hold that, even though there is no *de facto* corporation, one who deals with the association as a corporation is estopped to deny its existence as such

in order to escape liability, if he has obtained a benefit from the transaction, as in a case where he has purchased goods from the association. Nor can he, in such a case, hold the members individually liable. If, however, fraud has been practiced upon him, he would not be estopped to hold the members as partners. The members, likewise, who have held out the appearance of a corporation are estopped from denying its existence. The decisions are so various, however, that the law of the particular jurisdiction should be consulted by anyone concerned with a practical question in this field.

4. *Promoters' duties and liabilities.*—A promoter may be defined briefly as one who undertakes to organize a corporation. He brings together the persons who are to be interested in the enterprise, aids in procuring stock subscriptions, "and sets in motion the machinery which leads to the formation of the corporation itself." A promoter is held to a high standard of conduct by the law. Like a director, he occupies a position of trust and confidence. Too often, unfortunately, promoters do not merit trust and confidence. Like a director, the promoter must act in the highest good faith toward the corporation to be organized. He must not sell property to the corporation without first making a full disclosure of his ownership of the property. He may not make any secret profit at the expense of the unborn corporation. If, for example, the promoter acting for the owner of the property gets a commission for ar-

ranging a sale of the property to the corporation, he may be compelled to account for it to the corporation. Likewise, if the promoter himself buys property for the purpose of selling it to the corporation at a profit, the corporation can recover from him any profit so obtained.

On the other hand, a person who desires to incorporate a going business and to sell the business property to the corporation may sell to the corporation at any reasonable price he chooses, provided his interest in the property is disclosed and no misrepresentations are made and the purchase is approved by a board with independent judgment which is not made up merely of "dummies" put in by the promoter. So, also, he may exchange his property for stock under the same conditions. In short, as long as the promoter acts in good faith and no one is harmed, his transactions with the corporation are legal, but, if he acts fraudulently, he may be held to account.

5. *Promoters and subscribers.*—Besides being liable to the corporation for fraud upon it and for secret profits made at its expense, promoters are liable to subscribers to the stock of the corporation who are induced to purchase its securities by false statements, knowingly made by promoters or their agents in regard to the property and condition of the company.

6. *Pre-incorporation contracts.*—Ordinarily, when a corporation is about to be formed, various contracts are entered into. One class of contracts comprises

agreements between the incorporators dealing with the organization of the corporation. Such agreements may provide for the purposes, stock structure, and various like details of organization and management. These agreements are not binding upon the corporation, until incorporated into its charter and by-laws.

Other contracts are entered into between the promoters and third persons for the benefit of the future corporation, such as contracts for the leasing of premises, the purchasing of property, and the employment of officers. Such agreements do not become automatically binding upon the corporation when it comes into existence, since there can be no agency on behalf of a non-existent principal. The corporation, however, in most jurisdictions, may adopt the contract by an express resolution of the board of directors or by an implied adoption by taking the benefit of the contract. In Massachusetts, it seems, the courts hold that the corporation cannot adopt such a contract by mere resolution or by acceptance of benefits and that the corporation can be bound only by means of a new contract with the corporation as a party.

In any jurisdiction, the corporation may decline to adopt such a contract, without liability.

Care should be taken in drawing up pre-incorporation contracts to insert a provision that the parties thereto are not to be personally liable (if such is the intention) in the event that the corporation is not organized or does not adopt the agreement.

7. *Subscription agreements.*—Formerly, it was customary, when the organization of a corporation was contemplated, to circulate a subscription list for the purpose of ascertaining whether sufficient capital could be obtained. This is still necessary upon many occasions, but, perhaps, in the more ordinary case, the corporation is first organized and stock is subsequently sold to the extent that may be necessary to obtain working capital.

Where agreements are made to purchase stock in a corporation yet to be organized, there are different views as to the binding effect of the subscription. The weight of authority is that such agreements are, in effect, offers to the proposed corporation which may be accepted by it after it comes into existence. Like any other offer, it may be revoked by withdrawal before it is accepted. Upon acceptance by the corporation, the subscriber becomes a stockholder. In some states, a subscription agreement is regarded as a binding contract between the several subscribers. Frequently, the matter is controlled by the state statutes which should be consulted.

A subscription may be so worded as to create a binding contract between the subscribers themselves. If the subscription paper evidences the intent of the subscribers to enter into mutual agreement, the promises respectively afford consideration for each other and a contract between the subscribers arises. This contract will inure to the benefit of the corporation contemplated by the subscribers and will

be irrevocable. The corporation, however, would not be bound to recognize such subscribers as stockholders unless it assented.

8. *Stockholders' right to subscribe to new stock.* —A stockholder of a going corporation has a right to subscribe to a new issue of stock in the proportion that the number of shares held by him bears to the whole number before the increase. This is a property right that cannot be taken away from him without his consent, or a waiver implying consent. The reason for this is well put in a leading New York case:

> The plaintiff had power, before the increase in stock, to vote on 221 shares of stock, out of a total of 5,000, at any meeting held by the stockholders for any purpose. By the action of the majority, taken against his will and protest, he now has only one-half the voting power that he had before, because the number of shares has been doubled while he still owns but 221. This touches him as a stockholder in such a way as to deprive him of a right of property. (Stokes *v.* Continental Trust Co., 186 N. Y. 285.)

This right to subscribe to a new issue is one that can be sold by the stockholder, if he does not desire to exercise it himself.

This right does not exist, however, when the new stock is issued in payment for property, nor has the stockholder any such absolute right to subscribe to the unsold portion of an original issue.

9. *A stockholder's right to sue.*—The majority of the voting stock controls the corporation, and, as long as the majority of stockholders act within their pow-

ers and within the powers of the corporation, as a general rule the minority will not be heard to complain in court.

The management of the corporation is vested in the board of directors and, as long as the directors act in good faith and within their powers, the stockholders as a body have no legal grievance.

A stockholder, however, has a right to maintain an action in his own name to restrain threatened acts which are beyond the powers of the majority or of the directors or which are fraudulent and oppressive, and which directly injure him as a stockholder. If the acts threatened or consummated injure the corporation as a whole, a restraining suit for redress is generally required to be brought in the name of the corporation, or by a stockholder on behalf of the corporation, if he cannot get the corporation to act for itself.

The matter has been admirably summed up by the United States Supreme Court as follows:

> We understand the doctrine to be that to enable a stockholder in a corporation to sustain in a court of equity, in his own name, a suit founded on a right of action existing in the corporation itself, and in which the corporation itself is the appropriate plaintiff, there must exist as the foundation of the suit:
>
> Some action or threatened action of the managing board of directors or trustees of the corporation which is beyond the authority conferred on them by their charter or other source of organization;
>
> Or such a fraudulent transaction completed or contemplated by the acting managers, in connection with some

other party, or among themselves, or with other shareholders, as will result in serious injury to the corporation, or to the interests of the other shareholders;

Or where the board of directors, or a majority of them, are acting for their own interest, in a manner destructive to the corporation itself, or to the rights of the other shareholders;

Or where the majority of shareholders themselves are oppressively and illegally pursuing a course in the name of the corporation, which is in violation of the rights of the other shareholders, and which can be restrained only by the aid of a court of equity.

Possibly other cases may arise in which, to prevent irremediable injury, or a total failure of justice, the court would be justified in exercising its power, but the foregoing may be regarded as an outline of the principles which govern this class of cases. (Hawes *v.* Oakland, 104 U. S. 450, 26 L. Ed. 827.)

10. *Involuntary dissolution and receiverships.*— The matter of the voluntary dissolution of a corporation is discussed in textbooks dealing with business organization. At this point a few words will be added as to involuntary dissolution and reorganization. Involuntary dissolution usually arises when a corporation becomes insolvent and, generally, but not necessarily, is accompanied by bankruptcy proceedings. Sometimes it may be desired to keep an insolvent corporation alive with a view to a reorganization, and, upon the petition of the creditors or of the board of directors, a receiver may be appointed, if the interests of all require the protection of the property and business of the company against conflicting suits and judgments, until its affairs can be

liquidated in an orderly manner and its creditors paid.

The receiver is a trustee of the property and business of the company, which he holds for the benefit of creditors and stockholders, subject to the control and authority of the court that appointed him. The receiver is considered an officer of the court and has almost unlimited power over the property and affairs of the company. He is strictly accountable to the court, however, and may be retired or replaced at any time, if his administration is not satisfactory to the court. Sometimes several receivers are appointed, but this only divides the duties and responsibilities among them, and does not alter the legal aspect of of the matter.

11. *Reorganization.*—Involuntary dissolution and reorganization are closely associated. Whether a corporation in financial difficulties will be dissolved under the protection of a receiver or will be reorganized and continue in business, depends very largely upon the amount of salvage left in the wreck after the payment of creditors, and upon the ability of the stockholders to reorganize the management and procure additional financing.

Methods of effecting reorganization vary according to circumstances, although certain elements of procedure are quite common. It frequently happens that creditors are deeply interested in the reorganization of a company in distress, in order that they may retain a valuable customer. Sometimes, also, the personal relationships between the owners or of-

ficers of the company and its creditors are very friendly. Under such circumstances, a great deal of coöperation sometimes will be extended by creditors to assist the owners in reorganizing the company and discharging the receiver.

It not infrequently happens that creditors accept the obligations of the reorganized company in part payment, upon such terms that the receiver may be dismissed and the corporation continue its business under new management and new capitalization.

In bankruptcy, the receiver, of course, is expected to press forward diligently in liquidating the assets of the company, paying off its creditors and winding up the business. In a receivership established by a court of equity, and not in bankruptcy, the receiver may continue almost indefinitely to operate the business, taking into account, primarily, the payment of creditors, and, secondly, the preservation of the assets and reorganization of the business.

The actual reorganization in such a case is not the function of the receiver, but his coöperation is essential, if a reorganization is to be effected. Reorganization is usually the result of successful operation and coöperation on the part of the receiver, coupled with the participation of the various stockholders and creditors in a plan to rehabilitate the company by extending the payment of its obligations, procuring new capital, and revising the management and capitalization to satisfy all concerned, resulting in their consent to discharge the receiver.

It is generally too late to reorganize a corporation when it goes into the bankruptcy court, although such reorganizations are not unknown. It is sometimes too late to reorganize when a corporation goes into the hands of a receiver appointed by an equity court, although such reorganizations are quite frequently effected. The right time to reorganize a company is in the beginning of its financial difficulties, before its credit has been too greatly impaired and while there is still some confidence in its management. Reorganization is usually not difficult when it is promptly, vigorously, and intelligently undertaken, but it is very difficult in the later stages of insolvency, and especially so after the appointment of a receiver.

REVIEW

State what is meant by *de facto* corporations and the requisites for their existence.

Outline the obligations of a promoter and his liabilities.

Explain the effect of pre-incorporation contracts.

Give the reason why a stockholder has the right to subscribe to new stock.

State the rules governing a stockholder's right to sue individually or on behalf of the corporation.

CHAPTER XIX

TRUST RELATIONSHIPS

1. *Nature of the trust relationship.*—In certain relationships, one assumes an obligation to disregard or eliminate his own pecuniary interest and to act solely in the interest and for the benefit of another. These are fiduciary relationships. Such a relationship exists where one holds an interest in, or power affecting, property of any kind for the benefit of another. The obligation arises out of the confidence reposed in the one so holding the interest or power. The fiduciary relationship so created is a "technical trust." The person holding the property or power is the trustee; the person for whose benefit it is held is the beneficiary, or *cestui que* trust (one who trusts a person who has the equitable and beneficial interest in property, the legal interest in which is vested in a trustee); the thing held is the trust fund, trust estate, or *res*. To constitute a technical trust, it is essential that there be:

(a) A trustee
(b) Another person who is beneficiary
(c) The property

The fiduciary relationship occurs in various transactions, some of which are not technically trusts.

Some of the more frequent fiduciary or trust relations are those of executors, administrators, bailees, guardians, agents, partners, directors of corporations, and assignees for specific purposes. In short, a fiduciary relationship arises whenever one person receives the money or property of another for a particular purpose. Mention of the fiduciary duties of agents, bailees, partners, and directors of corporations has been made in previous chapters.

When a trust is created by the positive and direct act of the parties in writing, it is called an express trust. For example, Jones, by a writing operative in his lifetime or by will, gives to the Loyalty Trust Company money or property to be held by it for the benefit of his son Henry. An express trust is thereby created. If Jones additionally provides that such trust fund is not to be subject to the demands of any creditor of the son, it is called a spendthrift trust.

When a trust is not so expressly created but it can be seen from the words or acts of the parties that such a relationship was intended, or when equitable principles require the imposition of such an obligation to prevent fraud, an implied trust is created. To illustrate, if Jones, in order to conceal his identity, should furnish his friend the money with which to open and operate an account with a stockbroker in the friend's name, the friend would become a trustee, and Jones, the *cestui que* trust. The friend would have the legal ownership, i.e., the

title, while Jones would have equitable title, so-called because his interest could be enforced or protected only in a court of equity instead of a court of law.

2. *Trust property.*—Any property or right which can be conveyed, transferred, or assigned can be made the subject of a trust. Frequently, property is held under a trust giving the income to one person and the property itself to another. In such cases, puzzling questions arise as to what is income and what is the *corpus* (the principal of a fund or estate, as opposed to interest, income, dividends or the like) of the trust estate. If a fund of $50,000 is invested in bonds, the interest received is income, but, if the trustee should exchange the bonds for other bonds worth $55,000, the resulting increase of $5,000 would be treated not as income but as an addition to the body or *corpus* of the trust estate. If the bonds depreciate in value in the hands of the trustee, the interest is still income and cannot be added to the *corpus* to make good the deficiency unless the provisions creating the trust expressly so provide.

When corporate stock is held in trust, all cash dividends paid out of surplus earnings are income. Stock dividends have been the subject of conflicting decisions in different states and so the fiduciary must ascertain the prevailing view in the particular jurisdiction. When capital stock is sold and repurchased or exchanged into other stock, the resulting profit is *corpus,* not income. When a trustee of a mortgage forecloses, buys the property at the foreclosure sale

and afterwards sells it at a profit, the resulting profit is regarded as an increase in *corpus,* not as income.

The trustee's accounts should be kept so as to show the exact nature of each item, whether it is a part of the income or the *corpus* of the trust property, whether it is a loss or an expense incident to the management of the trust. If the fiduciary mingles the trust property with his own, he violates his trust. If, because of such an act, the trust property cannot be separated from his own, the whole will be treated as trust property, at least, so far as necessary for the full protection of the beneficiary. Proper accounting by a fiduciary is a matter of the utmost importance. The subject, however, falls outside of the scope of this Text.

3. *Rights and duties of trustee.*—The first duty of one undertaking a fiduciary obligation in respect to property is to take possession of the property, or to secure control, or notify obligors or custodians of the property of the interest which he has acquired. Diligence in this respect is usually necessary to protect the estate from loss. Delay resulting in loss is likely to be deemed negligence, especially delay in the collection of debts constituting the trust *res.*

If a suit is necessary to collect a claim and the trustee employs an attorney through whose delay the claim becomes uncollectible, the trustee will not be liable. Employment of an attorney in such event is necessary or at least usual and the trustee may rely upon the attorney.

The trustee is the legal owner of the trust property and has all the rights and obligations of an owner, and more. A personal confidence is reposed in him which demands absolute good faith and reasonable diligence. It is not enough that he deal with the property as he would with his own.

He may, for example, intrust his own affairs to others, but he may not delegate to another a duty which he owes to the beneficiary, unless such delegation is the usual and necessary means to the particular end, as in the employment of an attorney to bring suit. Again, if his fiduciary obligation requires the investment of funds, he may seek advice, but he cannot delegate the duty of deciding what investments shall be made. He is bound to exercise ordinary skill and judgment. If he feels that he is not qualified, he should not accept the trust.

If several persons are cotrustees, they must act unanimously, for the judgment of all is requisite. If they cannot agree, they cannot act, unless the provisions creating the trust provide or contemplate action by a majority. When partners are appointed to a fiduciary relationship in the firm name, it is contemplated that they will act in their capacity as partners. Therefore, one partner could act in discharge of the fiduciary obligations.

Here it is necessary to distinguish between public and private trusts. A public trust is one established for the benefit of the public or for a considerable portion of it, such as trusts for religious or educa-

tional purposes, for hospitals, orphanages, etc. In such a trust, cotrustees are usually named and are authorized to act by a majority of the entire number who are qualified. One trustee is not responsible for the dishonesty or negligence of a cotrustee in the absence of connivance or bad faith. Nor is it negligent for one trustee to allow a cotrustee to retain possession of the trust property when there is no reason to suspect him of irregularity.

4. *Investments by trustee.*—It is the duty of a trustee to invest the trust fund so that it shall, first of all, be safe; and, secondly, yield a reasonable income, subject, of course, to instructions in the instrument giving rise to the trust. The trustee may not lend trust funds upon the personal security of anyone. Since a promissory note is simply evidence of a debt but not security for it, he may not loan on such an instrument.

The trustee should not allow funds to lie in a bank for a long period when good investments are available. In general, the trustee is limited to investments in first mortgages on real estate and in government and municipal bonds. He cannot invest funds in trade or manufacturing. In some states, he cannot invest in the stocks of corporations engaged in trade or manufacturing or transportation. In some others, in recognition of the investment status which the stocks of some corporations have attained, trustees are permitted to invest in bank stocks and the stocks of public utilities, and insurance corporations. It

behooves the fiduciary to ascertain what investments are legal in his state.

If the trustee unreasonably delays the investment of the trust fund, he is personally liable for the interest lost. If he invests the trust fund improperly and it is lost, he is personally liable for the loss. If his improper investment proves profitable, the beneficiary alone is entitled to the profits.

The instrument creating the trust, of course, may authorize investment in specific securities or enterprises. If the beneficiary is an adult and competent, he may assent to or request a particular investment. In that event he cannot compel the fiduciary to bear the loss, if the latter has acted in good faith.

5. *Other duties of a trustee.*—The trustee can take no profit to himself, directly or indirectly, except as provided in the trust instrument. He is entitled to reasonable compensation for his services. If such compensation cannot be agreed upon, the court will fix it upon the trustee's accounting. For necessary disbursements, the trustee may at any time reimburse himself out of trust funds.

It is the trustee's duty to keep full and intelligible accounts and to be prepared to render a full account supported by vouchers at all times. When the beneficiaries are competent adults, the trustee should consult their wishes but not be controlled by them, unless such control is contemplated by the trust instrument. While the trustee for bondholders, since he is appointed only for convenience, must carry out

the wishes of the bondholders, the trustee of a spendthrift trust would ordinarily not be controlled by his beneficiary, since such trusts are usually created because of lack of confidence in the wisdom of the beneficiary.

A guardian of an infant's property is required to secure the approval of the proper court for practically every payment made out of the trust property, regardless of the purpose or necessity for such payment.

6. *Relations of third persons to the trust.*—When a person holds property in trust or in a fiduciary relationship, a third party who deals with him concerning the trust property must take notice at his peril of the extent of the fiduciary's authority. If the third person receives such property with notice of the trust, but in violation of its terms, he is guilty, equally with the trustee, of a fraud upon the beneficiaries. This principle extends to all fiduciary relationships, regardless of whether they are technical trusts or not. A third person who receives firm property in payment of the debt of a partner, or who receives from the guardian of an infant any part of the trust estate not paid or delivered for an authorized purpose, becomes accountable to the copartners or infant to the extent of the value of the property or estate received.

When a trustee or executor or other fiduciary deposits trust funds in a bank, the bank may become accountable to the beneficiary, if it knowingly honors

checks drawn against the fund for unauthorized purposes. Hence, it is the common practice for banks receiving such deposits to require the filing with them of copies of the trust instrument or court order under which the fiduciary is acting, so that they may investigate the legal status of the payment before cashing or passing such checks.

If the transaction appears to be a valid exercise of the authority of the fiduciary, if there are no suspicious circumstances and the third person acts in good faith and gives full value for whatever he receives, the latter's rights are not questioned and his title will be protected by the courts, regardless of the fraudulent conduct of the fiduciary. Property subject to a fiduciary relationship may be traced and recovered as long as it, or the proceeds of it, can be identified, but only until they reach the hands of a bona fide purchaser for value. To take them from such a holder and restore them to the beneficiary would be to commit one injustice in order to redress another. This a court of equity will not do.

The creditors of the trustee or fiduciary individually cannot levy upon the trust property. Their only remedy is against his individual property. Those who have extended credit to him in such capacity or have rendered services to the trustee which have benefited the trust estate must also look to the trustee individually for payment, in most states. He becomes personally liable upon such contracts and may reimburse himself from the estate in a proper

case. In some of the states, by express terms of the contract, he can limit liability on the contract to the trust property.

7. *Rights of beneficiary.*—The beneficiary has the right to compel the trustee to carry out the terms of the trust. If there is reason to suppose that the trustee is about to act in violation of the confidence reposed in him, the beneficiary may secure an injunction restraining the trustee. The beneficiary is entitled to an accounting by the trustee as often as necessary for his protection. When the purposes of the trust have been accomplished, the beneficiary has the right to compel the trustee to transfer the trust property to him.

If any of the trust property has come into the hands of a third party who is not a bona fide purchaser for value, the beneficiary may compel him to make restitution or account for the property. In fact, if the trustee at any time fails to act with diligence in the collection of money or the enforcement of rights affecting the trust, the beneficiary in his own name may enforce his rights by proper legal proceedings against the third party. Even though the legal title is in the trustee, the beneficiary is not confined to his action against the trustee for neglect. But before taking action against the third person, the beneficiary must demand such action by the trustee, the general rule being that actions should be brought by the person having the legal title to the right or property involved.

REVIEW

Define: trustee; *cestui que* trust; trust *res;* express trust; implied trust.

State why it is important to keep the trust *corpus* and income separate.

Outline the rights and duties of a trustee.

How are the investments of a trust fund limited?

Describe the rights of a beneficiary.

CHAPTER XX

BANKRUPTCY

1. *Introduction.*—When we speak of "bankruptcy" in a technical legal sense, we refer to the provisions of the laws enacted by Congress rather than to the popular meaning of the word, or to any statutes enacted by the several states with reference to insolvency. The Constitution of the United States provides that Congress shall have power to establish uniform laws on the subject of bankruptcy throughout the United States. Under this provision of the Constitution, Congress from time to time has enacted and amended bankruptcy laws.

Many states also have laws pertaining to insolvency. Wherever such state laws conflict with the Federal law, the latter governs. There are many state laws regulating assignments for the benefit of creditors, or declaring invalid transfers in contemplation of insolvency for the purpose of hindering or defrauding creditors. These are not insolvency laws, and they are not rendered inoperative by the Federal Bankruptcy Law. Acts under them or to which they relate, however, may constitute acts of bankruptcy under the Federal statute.

A person is insolvent within the meaning of the

Bankruptcy Law whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed or removed, or permitted to be concealed or removed with intent to defraud, hinder or delay his creditors shall not be sufficient in amount, at a fair valuation, to pay his debts.

The courts have held that "insolvency" means something more than that the debtor is financially embarrassed and hard pressed by his creditors. By a "fair valuation" is meant the amount that the property will probably bring, or is worth, in the general market as of that day.

2. *Who may become a bankrupt?*—Any person or corporation, except a municipal, railroad, insurance, or banking corporation, is entitled to the benefits of the Bankruptcy Law as a voluntary bankrupt. Any natural person, except a wage earner, or a person chiefly engaged in farming or in tilling the soil; any unincorporated company and any commercial corporation, except a municipal, railroad, insurance or banking corporation, owing debts to the amount of $1,000 or over, may be adjudged an involuntary bankrupt. A partnership, before or after its dissolution, and before the final settlement, may be adjudged a bankrupt.

3. *Acts of bankruptcy.*—A person commits an act of bankruptcy:

(a) When he conveys, transfers, conceals or removes, or permits to be concealed, or removed, any

part of his property with intent to hinder, delay, and defraud his creditors, or any of them

(b) When he transfers, while insolvent, any portion of his property to one, or more, of his creditors, with intent to prefer such creditors over his other creditors

(c) When he suffers or permits, while insolvent, any creditor to obtain a preference through legal proceedings, and does not, at least five days before sale, or other disposition of any property affected by such preference, vacate or discharge such preference

(d) When he suffers or permits, while insolvent, any creditor to obtain through legal proceedings any levy, attachment, judgment, or other lien and does not vacate or discharge the same 30 days from the date when such levy, attachment, judgment, or other lien is obtained

(e) When he makes a general assignment for the benefit of his creditors

(f) When he permits, while insolvent, a receiver or trustee to be appointed for him or put in control of his property

(g) When he admits in writing his inability to pay his debts and his willingness to be adjudged a bankrupt on that ground

4. *When a petition may be filed.*—A petition to have a person adjudged a bankrupt may be filed against a person who is insolvent and who has committed one of the acts of bankruptcy above named, within four months after the commission of such act. Such time does not expire until four months after the date of the recording or registering of the transfer or assignment, when the act consists in having made a transfer of any of his property with intent

to hinder, delay, or defraud his creditors, or for the purpose of giving a preference as above outlined.

Whenever a person against whom a petition has been filed denies the allegation of insolvency, it becomes his duty to appear in court on the hearing with his books, papers, and accounts, to submit to examination, and to give testimony as to all matters tending to establish his solvency or insolvency. If he fails to attend and submit to an examination, the burden of proving his solvency rests upon him.

When three or more creditors have provable claims against any person, which amount, in the aggregate —in excess of the value of any securities held by them—to the sum of $500 or over, or if the creditors of such person are less than twelve, then one such creditor, whose claim equals such amount, may file a petition to have him adjudged a bankrupt.

Petitions must be filed in duplicate, one copy for the clerk, and one for service upon the bankrupt.

At any time, creditors, other than the original petitioner, may enter an appearance and join in the petition, or file an answer and be heard in opposition to the prayer of the petition.

5. *Appointment of receivers.*—Simultaneously with the filing of the petition in bankruptcy by a creditor, it is frequently advisable to apply to the court for the appointment of a custodian or receiver to take charge of, and hold the property of, the alleged bankrupt, prior to the adjudication and pending a hearing. In such a case, the petitioner must

file in the same court a bond in such form as the court may direct, conditioned for the payment to the alleged bankrupt in case such petition is dismissed, of all costs, expenses, and damages occasioned by the seizure, taking, and detention of the property of the alleged bankrupt. If a petition in bankruptcy is dismissed by the court, or withdrawn by the petitioner, the alleged bankrupt must be allowed all costs, counsel fees, expenses, and damages occasioned by such seizure, and taking or detention of the property. The sum is fixed by the court. In addition, the petitioner is liable to the alleged bankrupt for any damages sustained by him in his business and business reputation.

6. *Duties of bankrupts under the law.*—Bankrupts, whether voluntary or involuntary, must:

(a) Attend the first meeting of creditors, if directed by the court, and, at the hearing upon their application for a discharge, to comply with all lawful orders of the court
(b) Examine the correctness of all proofs of claim filed against their estates
(c) Execute and deliver all such papers as shall be ordered by the court
(d) Execute to their trustees transfers of all their property in foreign countries
(e) Inform their trustees immediately of any attempt by their creditors or other persons to evade the provisions of the bankruptcy law of which they have knowledge
(f) Apprize the trustee of any false claim against their estates

(g) Prepare and swear to, and file in court within 10 days after adjudication if involuntary bankrupts, and within 10 days after the filing of such petition if voluntary bankrupts, unless exceptional circumstances are shown, schedules of their property showing the amount and kind of property, the location thereof, its money value in detail, and a list of their creditors with their residences, the amount due to each of them, the consideration therefor, the security held by them, if any, and also a claim for such exemption as the bankrupts may be entitled to under the state law

Some of the state laws provide that certain property shall be exempt from seizure by creditors, and the Bankruptcy Law respects the exemptions thereby granted. The bankrupts are also required to submit to examinations concerning the conduct of their business, the causes of bankruptcy, their dealings with creditors and other persons; and the amount and whereabouts of their property. This testimony cannot be used in any criminal proceeding.

7. *Meetings of creditors.*—The law provides that the court shall cause the first meeting of creditors of a bankrupt to be held in not less than 10 days, or more than 30 days, after the adjudication. At the first meeting of creditors, the judge or referee presides, and, before proceeding with other business, he examines and allows or disallows the claims of creditors, and examines the bankrupt or causes him to be examined at the instance of any creditor.

The law provides that the creditors shall at each meeting take such steps as may be pertinent and necessary for the promotion of the best interests of the estate. Generally, the trustee is elected at the first meeting. Special meetings of creditors may be held at any time upon the request of all creditors whose claims have been allowed, or upon the request of one-fourth in number of those who have proved their claims. Creditors pass upon matters submitted to them at any meeting by a majority vote in number and amount of claims of all creditors whose claims have been allowed.

8. *Proofs of claims.*—"Proof of claim" is the name given to the written statement under oath signed by the creditor, setting forth his claim, the consideration therefor, and whether any securities are held by him and, if so, what payments have been made thereon and the sum claimed to be justly due and owing from the bankrupt to the creditor. A form of claim is now being generally sent out by the referees in bankruptcy to all creditors, such form having been approved by the courts.

Whenever a claim is founded upon an instrument in writing, such as a check or note, such instrument, unless lost or destroyed, must be filed with the proof of claim. After the claim is allowed or disallowed, the instrument may be withdrawn by permission of the court, upon leaving a copy on file with the claim.

Claims which have been duly proved are allowed, upon receipt by the court or the referee, unless ob-

jections to their allowances are made by parties in interest.

Notice of objection to claims is generally given to the creditors in writing, and hearings on claims are then held. Proofs of claim must be filed against the bankrupt estate within six months after adjudication, and, if they are not filed within that time, except in certain circumstances, the claim may be barred.

9. *Notices to creditors.*—Creditors are entitled to 10 days' notice by mail of all examinations of the bankrupt; of hearings upon application for the confirmation of discharges; of meetings of creditors; of proposed sales of property; the declaration and the time of payment of dividends, the filing of the final accounts of the trustees and the time when, and the place where, they may examine and pass upon the proposed compromise of any controversy, the proposed dismissal of proceedings, and to at least 30 days' notice of all applications for a discharge of the bankrupt.

10. *Dividends.*—The law provides that dividends of an equal percentum shall be declared and paid on all allowed claims, except such as have priority or are secured. The first dividend must be declared within 30 days after adjudication, if the money in the estate is sufficient, after paying claims which have priority, to permit a distribution equivalent to 5 per cent of all claims, whether allowed or not.

11. *Debts which have priority.*—The following debts have priority in advance of the payment of

dividends to general creditors and are to be paid in full out of the bankrupt's estate in the following order:

(a) The actual and necessary cost of preserving the estate subsequent to the filing of the petition

(b) The filing fees paid by the creditors in involuntary cases, and, where the property of the bankrupt, transferred or concealed by him either before or after the filing of the bankruptcy petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the expense of one, or more, creditors, the reasonable expense of such recovery

(c) The cost of administration, including the fees paid: to witnesses and one reasonable attorney's fee for professional services actually rendered, irrespective of the number of attorneys employed; to the petitioning creditors in involuntary cases while performing the duties prescribed under the law; and to the bankrupt in involuntary cases, as the court may allow

(d) Where the confirmation of the composition terms has been refused or set aside upon the objection or through the efforts, or at the expense of one, or more, creditors, in the discretion of the court, the reasonable expenses of such creditor in opposing such composition may be allowed

(e) Wages due to workmen, clerks, traveling or city salesmen or servants, which have been earned within three months before the date of the commencement of the proceeding, not exceeding $600 to each claimant

(f) Taxes due to any city, state, county, or federal government

(g) Debts owing to any person, who by the laws of the state or of the United States is entitled to priority

12. *Preferred creditors.*—A person is deemed to have given a preference, if, being insolvent, he has, within four months before the filing of the petition, or after the filing of the petition and before the adjudication, procured, or suffered a judgment to be entered against him, in favor of any person, or made a transfer of any of his property, and the effect of the enforcement of the judgment or transfer enables anyone of his creditors to obtain a greater percentage of his debts than any of the other creditors of the same class.

13. *Compositions and settlements.*—A bankrupt may offer, either before or after adjudication, terms of composition or settlement to his creditors, but not before he has been examined in open court, or at a meeting of his creditors, and has filed in court schedules of his property and a list of all of his creditors required to be filed by bankrupts.

In a composition before adjudication, the bankrupt is required to file the schedules, and thereupon the court calls a meeting of the creditors for the allowances of claims, the examination of the bankrupt, and the preservation or conduct of the estate, at which meetings the judge or referee presides.

An application for the confirmation of a composition may be filed in the court of bankruptcy after, but not before, it has been accepted in writing by a

majority in number of all creditors whose claims have been allowed, which number must represent a majority in amount of such claims. The consideration to be paid by the bankrupt to his creditors, and the amount necessary to pay all debts which have priority, and the costs of the proceedings must be deposited in such place as shall be designated by, and subject to, the order of the judge.

Thereafter, a date is fixed for the hearing upon the application for the confirmation of the composition, at which time creditors and others may appear and object. The law provides that the judge shall confirm a composition, after he is satisfied that it is for the best interests of the creditors, that the bankrupt has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to his discharge, and that the offer and its acceptance are in good faith and have not been made or procured, except as provided by law, or by any means, promises, or acts forbidden by law.

Upon confirmation of the composition, the consideration is distributed as the judge directs and the case is dismissed. Whenever a composition is not confirmed, the estate is administered in bankruptcy.

At any time within six months after a composition has been confirmed, the judge, upon the application of any parties in interest, for good cause, may set aside the composition and reinstate the case, if it is shown upon a trial that fraud was practiced in procuring such composition, and that the knowledge

of such fraud came to the petitioner since the composition.

14. *Discharges.*—A person, after the expiration of one month, and within twelve months subsequent to being adjudged a bankrupt, may file an application for a discharge in the court of bankruptcy in which the proceedings are pending. If it appears to the judge that the bankrupt was unavoidably prevented from filing it within such time, it may be filed later, but not after the expiration of the next six months.

Upon the filing of the petition for discharge, the referee sends to all of the creditors notices to the effect that there will be a hearing before the United States District Judge on a certain day, generally about six weeks after the notice has been given, at which hearing the bankrupt's name is called and, if any person objects, he may file a notice of objection, to be subsequently followed up within 10 days by the filing of specifications of objection. Upon such call of the case in court, if no objections are filed, the discharge is granted as a matter of course. Objections to the discharge of a bankrupt may be filed if the bankrupt has:

(a) Committed an offense punishable by imprisonment as provided by the bankruptcy law

(b) Destroyed, mutilated, falsified, concealed, or failed to keep books of account or records, from which his financial condition and business transactions might be ascertained, unless the court deems such failure or acts to have been justified under

the circumstances of the case, and, therefore, exonerates the bankrupt from any charge of malicious intent

(c) Obtained money, or property, on credit, or obtained an extension, or renewal of credit, by making or causing to be made in any manner whatsoever a materially false statement in writing respecting his financial condition

(d) At any time subsequent to the first day of the twelve months immediately preceding the filing of the petition, transferred, removed, destroyed, or concealed, or permitted to be removed or concealed, any of the property, with intent to hinder, delay, or defraud his creditors

(e) Obtained a discharge in bankruptcy within six years

(f) In the course of the proceedings in bankruptcy refused to obey any lawful order, or answer any material question approved by the court

(g) Failed to explain satisfactorily any losses, assets, or deficiency of assets to meet his liabilities

Upon the hearing in opposition to the discharge, the objector must show to the satisfaction of the court that there are reasonable grounds for believing that the bankrupt has committed one or more of the acts which would prevent his discharge in bankruptcy. The burden of proving that he has not committed any of such acts is then upon the bankrupt.

A trustee may not interpose objections to a bankrupt's discharge, until he is authorized so to do by creditors at a meeting called for that purpose, upon the application of any creditor.

The judge, upon the application of the parties in interest, who have not been guilty of undue delay (which application must be made within one year after discharge shall have been granted), may revoke the discharge upon a trial, if it appears that the discharge was obtained through the fraud of the bankrupt and that knowledge of the fraud has come to the petitioner since the granting of the discharge, and that the actual facts did not warrant the discharge.

15. *Debts which are not dischargeable.*—A discharge in bankruptcy does not release a bankrupt from the following:

(a) Debts due as a tax levied by the United States, the state, the county, the district, or municipality in which he resides

(b) Liabilities for obtaining property by false pretenses or false representations, or debts incurred by reason of willful or malicious injury to the person or property of another

(c) Debts which have not been duly scheduled in time for proof and allowance, unless such creditor has notice or actual knowledge of the proceedings in bankruptcy

(d) Debts which were created by the bankrupt through fraud, embezzlement, misappropriation, or defalcation, or while acting as an officer or in a fiduciary capacity

(e) Debts which were due for wages to workmen, clerks, traveling or city salesmen, which have been earned within three months from the date or commencement of the proceedings in bankruptcy

(f) Debts for moneys due employees received, or retained, by the employer to secure the faithful performance by such employees of the terms of contracts of employment

(g) Alimony due, or to become due, for the maintenance or support of a wife or child or for seduction

16. *Criminal offenses.*—The Bankruptcy Law provides that certain acts shall be deemed to be offenses punishable by imprisonment or fine. Among the offenses punishable by imprisonment or fine, or both, that an individual may commit, are:

(a) Knowingly and fraudulently appropriating to his own use, embezzling, spending, or unlawfully transferring any property, or secreting any document belonging to a bankrupt estate, which came into his charge as a trustee, receiver, custodian, or other officer of the court

(b) Knowingly or fraudulently concealing from the receiver, trustee, United States Marshal, or other officer of the court charged with the control or custody of property, or from creditors in composition cases, any property belonging to the estate in bankruptcy

(c) Making a false oath or account in, or in relation to, any proceeding in bankruptcy

(d) Filing false claims or proofs under oath in compositions personally, or by agent, proxy or attorney

(e) Receiving any material amount of property from a bankrupt after the filing of a petition with intent to defeat the provisions of the law

(f) Receiving or attempting to obtain any money or property, remuneration, reward, or promise

from any person, for acting or forbearing to act in a bankruptcy proceeding

(g) After the filing of the petition, or in contemplation of bankruptcy, concealing, destroying, mutilating, or falsifying any book, document or record affecting or relating to the affairs of the bankrupt, or, after the filing of the petition, withholding from the receiver or trustee in bankruptcy any book, document, or paper affecting, or relating to, the property or affairs of the bankrupt to the possession of which the receiver or trustee is entitled

Where a referee or trustee has reason to believe that a criminal act has been committed, the law places the duty upon him to communicate the fact to the United States Attorney for the district in which this act has been committed, and the law makes it the duty of every United States Attorney to inquire immediately into the facts.

17. *Suits against bankrupts.*—A suit which is founded upon a claim to which a discharge in bankruptcy would be a bar, and which is pending against the bankrupt at the time of the filing of the petition against him, is stayed under the law until an adjudication or dismissal of the petition; and, if bankruptcy is adjudged, the action may be further stayed until twelve months after the date of adjudication, or, if within that time the bankrupt applies for a discharge, until the question of discharge is determined.

18. *Duties of referees.*—The bankruptcy proceedings are administered by the courts and by referees. Referees are lawyers who are appointed by the courts

to aid and assist them in connection with many of the intermediate steps.

Referees are required to declare dividends, to examine all schedules of property and lists of creditors, and to see that they are properly executed; to furnish information concerning the estates in process of administration before them, whenever they are requested by parties in interest; to give notices to the creditors.

Referees are ineligible to act in cases in which they are directly, or indirectly, interested, nor are they permitted to practice as attorneys at law in bankruptcy proceedings, nor to purchase directly, or indirectly, any property of an estate in bankruptcy.

19. *Contempts.*—Any person is guilty of a contempt before the referee, who disobeys or resists any lawful order or process made by a referee; or misbehaves during a hearing; or neglects to produce, after having been ordered to do so, any pertinent document; or refuses to appear after having been subpœnaed, or, after appearing, refuses to take oath or testify as a witness. The referee certifies these facts to the judge, and, if the judge, after a hearing, is satisfied that the acts complained of have been committed, he may punish the person in such manner and to the same extent as if a contempt were committed before a court of bankruptcy.

20. *Compensation of trustees and receivers.*—Trustees, receivers, and marshals receive for their services, payable after they are rendered, a fee of $5,

deposited with the clerk at the time the petition is filed, and, in addition thereto, commissions on all moneys disbursed and turned over to any person including lien-holders, not to exceed 6 per cent on the first $500 or less, 4 per cent on moneys in excess of $500 or less than $1,500, and 2 per cent in excess of $1,500 and less than $10,000, and 1 per cent on moneys in excess of $10,000.

REVIEW

Name three acts of bankruptcy.

How may creditors act to preserve the bankrupt's estate when filing a petition?

Distinguish between: secured claims; allowed claims; proved claims.

What debts have priority in the settlement of the bankrupt's estate?

Distinguish between an assignment for the benefit of creditors and a bankrupt's composition with creditors. Which is subject to approval by the court?

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